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TAXATION

by

Glen A. Rosenbaum*

I. ADMINISTRATIVE PROCEDURE AND TEXAS REGISTER ACT

As was noted in prior *Survey* Articles,¹ the enactment of article 6252—13a, the Administrative Procedure and Texas Register Act,² created uncertainties relating to the litigation of state tax cases. Many of these uncertainties remain unresolved.

In *Contran Corp. v. Bullock*³ the surviving corporation in a merger transaction filed suit, contending that it was entitled to a refund for the franchise taxes paid by the dissolved corporation prior to the merger. Although the corporation alleged that the franchise taxes in question had been “paid under protest, under implied duress, and through mistake of law and/or [sic] fact,”⁴ the record showed that the tax payment was made without an accompanying written protest pursuant to article 1.05⁵ or any other indication that it was a payment under protest. The district court ruled that the taxpayer corporation was not entitled to the relief sought.⁶ Affirming the district court, the court of civil appeals held that since the taxpayer did not include the written protest required by article 1.05(1) with its payment of the tax, the district court did not have jurisdiction and therefore properly entered judgment that the corporation take nothing. The court relied extensively on its previous decision in *Robinson v. Bul-*

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1. Rosenbaum, *Taxation, Annual Survey of Texas Law*, 32 Sw. L.J. 515, 516-17 (1978); Burke, *Taxation, Annual Survey of Texas Law*, 31 Sw. L.J. 435, 437-38 (1977).

2. TEX. REV. CIV. STAT. ANN. art. 6252—13a (Vernon Supp. 1978-79) [hereinafter referred to as the Register Act].

3. 567 S.W.2d 616 (Tex. Civ. App.—Austin 1978, no writ).

4. *Id.* at 616. Contran argued that correspondence between Contran and the comptroller prior to payment notified the comptroller of the specific ground of the protest at the time the tax was paid.

5. Section (1) of the protest statute, TEX. TAX.-GEN. ANN. art. 1.05 (Vernon 1969), provides:

(1) *Protest.* Any person, firm, or corporation who may be required to pay to the head of any department of the State Government any occupation, gross receipts, franchise, license or other privilege tax or fee, and who believes or contends that the same is unlawful and that such public official is not lawfully entitled to demand or collect the same shall, nevertheless, be required to pay such amount as such public official charged with the collection thereof may deem to be due the State, and shall be entitled to accompany such payment with a written protest, setting out fully and in detail each and every ground or reason why it is contended that such demand is unlawful or unauthorized.

6. The district court decision was discussed at Rosenbaum, *supra* note 1, at 516.

lock,⁷ in which it held that since the protest statute created a right not existing at common law and prescribed a specific remedy to enforce that right, the courts could act only in the manner provided by the statute. *Robinson* also held that there was no repugnancy between the protest statute and the Register Act; thus, the general repealer clause in the Register Act⁸ did not impliedly repeal the protest statute. The Limited Sales, Excise and Use Tax Act⁹ is the only state tax statute that expressly provides a procedure whereby a taxpayer may initiate a refund suit to recover taxes that were not paid under protest.¹⁰ As a result of the decisions in *Robinson* and *Contran*, there is no procedure whereby a taxpayer may initiate a refund suit to recover taxes, other than sales and use taxes, that were not paid under protest.

As was discussed in last year's *Survey* Article,¹¹ the uncertainties surrounding the applicability of the Register Act to state taxes would best be resolved by additional legislation. Such legislation should set forth specifically the jurisdictional basis for seeking review of a contested tax case as well as the manner of review. Legislation is also needed to authorize refund suits by taxpayers who remit taxes to the comptroller without protest. Pending resolution of these issues, caution dictates that taxpayers involved in state tax litigation comply with the requirements of both the protest statute and the Register Act. Taxpayers filing suit for the recovery of sales and use taxes should also comply with the requirements of article 20.10(G)-(I).¹² Furthermore, proceedings at the administrative hearing level should be conducted under the assumption that judicial review will be on the basis of the substantial evidence rule.

A significant procedural development during the survey period was the comptroller's decision to create an administrative law judge system to improve that office's resolution of contested hearings.¹³ Under the comptroller's newly adopted rules the administrative law judges will answer directly to either the comptroller or his chief clerk and will be physically separated from all other divisions of the comptroller's office.¹⁴ The hearings process consists of a two-level system. After a contested case is commenced by the

7. 553 S.W.2d 196 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

8. TEX. REV. CIV. STAT. ANN. art. 6252—13a, § 22 (Vernon Supp. 1978-79) provides as follows:

Chapter 274, Acts of the 57th Legislature, Regular Session, 1961, as amended (Article 6252—13, Vernon's Texas Civil Statutes), and all other laws and parts of laws in conflict with this Act are repealed. This Act does not repeal any existing statutory provisions conferring investigatory authority on any agency, including any provision which grants an agency the power, in connection with investigatory authority, to take depositions, administer oaths or affirmations, examine witnesses, receive evidence, conduct hearings, or issue subpoenas or summons.

9. TEX. TAX-GEN. ANN. arts. 20.01-.20 (Vernon 1969 & Supp. 1978-79).

10. *Id.* art. 20.10.

11. Rosenbaum, *supra* note 1, at 517.

12. TEX. TAX-GEN. ANN. arts. 20.10(G)-(I) (Vernon 1969).

13. Comptroller of Pub. Accounts, Rules 026.01.03.001-.043, 4 Tex. Reg. 868-72 (1979).

14. Letter from Bob Bullock, Comptroller of Public Accounts, to Glen A. Rosenbaum (Dec. 20, 1978).

filing of a petition for redetermination or for refund, the case proceeds to the first level, which involves a prehearing procedure designed to dispose of cases that do not present genuine disputes and generally can be resolved through explanation of the auditor's work, correction of oversights and mechanical errors, or acceptance of additional evidence.¹⁵ During the prehearing stage the comptroller will request the taxpayer to submit a statement of grounds¹⁶ that should: (1) list the items, individually or by category, with which there is disagreement; (2) set forth the factual and legal grounds why the tax should not be assessed or should be refunded with respect to each disagreed item or category; and (3) submit evidence to support each ground.¹⁷ If the taxpayer does not know the factual or legal basis of the comptroller's action that is the subject of the contested case, he may request from the comptroller's hearings attorney a more definite and detailed statement of the factual or legal basis of the action.¹⁸ A preliminary conference between the taxpayer and the hearings attorney may be scheduled at a mutually agreeable time to try to resolve the controversy, or to narrow disagreement as to the facts and define the legal issues involved.¹⁹ Following the submission of the taxpayer's statement of grounds and the preliminary conference, if one is held, the hearings attorney will send the taxpayer a position letter that will accept or reject, in whole or in part, each of the taxpayer's contentions.²⁰ The taxpayer must accept or reject the position letter within fifteen days after the date thereof on a form that will be provided for this purpose.

If the taxpayer rejects the position letter by signing the form motion to set for hearing, the proceedings move on to the second stage,²¹ which involves a formal hearing. The taxpayer may submit a reply to the position letter of the hearings attorney if he so indicates on his motion to set for hearing.²² The hearings attorney must file a response within twenty days after the taxpayer's reply is filed. Such response must state the comptroller's legal position and any factual disagreement with respect to each new issue or argument raised by the taxpayer.²³

When the hearing is convened by the administrative law judge, each party will have an opportunity to present his case on an issue by issue basis by calling and examining witnesses and introducing documentary evidence. Each party also shall have the opportunity to cross-examine opposing witnesses on any matter relevant to the issue even though the matter was not covered on direct examination.²⁴

15. The prehearing procedures are set forth at Comptroller of Pub. Accounts, Rules 026.01.03.006-.012, 4 Tex. Reg. 868-69 (1979).

16. *Id.* Rule 026.01.03.007, 4 Tex. Reg. at 868.

17. *Id.* Rule 026.01.03.009, 4 Tex. Reg. at 869.

18. *Id.* Rule 026.01.03.008, 4 Tex. Reg. at 869.

19. *Id.* Rule 026.01.03.011, 4 Tex. Reg. at 869.

20. *Id.* Rule 026.01.03.012, 4 Tex. Reg. at 869.

21. *Id.* Rule 026.01.03.013, 4 Tex. Reg. at 869.

22. *Id.* Rule 026.01.03.017, 4 Tex. Reg. at 869.

23. *Id.* Rule 026.01.03.018, 4 Tex. Reg. at 869.

24. *Id.* Rule 026.01.03.021, 4 Tex. Reg. at 870.

The rules of evidence set forth in the Register Act apply to all contested cases.²⁵ If the contested case involves the suspension or revocation of a permit or the imposition of additional penalty for willful or fraudulent failure to pay tax, the comptroller shall have the burden of proving by a preponderance of the evidence that such action is warranted. In all other cases, unless otherwise provided by law, the burden of proof shall be on the taxpayer to show by a preponderance of the evidence in what respect the action of the agency, as set out in the position letter, is incorrect.²⁶

Within thirty days after the record is closed, the administrative law judge will prepare a proposed decision setting out each finding of fact and conclusion of law necessary to the decision. The proposed decision will be served on the parties, and any party adversely affected may file exceptions and briefs within ten days.²⁷ Before the proposed decision of an administrative law judge is given any effect, it must be rendered by the comptroller.²⁸ The comptroller's decision becomes final fifteen days from the date of issuance, unless a motion for rehearing is filed on or before the fifteenth day.²⁹ To ensure access to the courts, any amounts found due in the comptroller's decision must be paid and suit for the recovery of such amounts must be timely filed in a district court of Travis County, Texas, pursuant to the provisions of the protest statute, article 1.05,³⁰ or in the case of sales and use taxes, pursuant to article 20.10.³¹

II. FRANCHISE TAXES

*National Bancshares Corp. v. Bullock*³² raised the question whether dividends and interest received by bank holding companies from national bank subsidiaries constitute gross receipts from business done in Texas pursuant to article 12.02(1)(b).³³ Texas has adopted the "location of

25. *Id.* Rule 026.01.03.022. This rule specifically refers to section 14(a) of the Register Act, which provides:

In contested cases, irrelevant, immaterial, or unduly repetitious evidence shall be excluded. The rules of evidence as applied in nonjury civil cases in the district courts of this state shall be followed. When necessary to ascertain facts not reasonably susceptible of proof under those rules, evidence not admissible thereunder may be admitted, except where precluded by statute, if it is of a type commonly relied upon by reasonably prudent men in the conduct of their affairs. Agencies shall give effect to the rules of privilege recognized by law. Objections to evidentiary offers may be made and shall be noted in the record. Subject to these requirements, if a hearing will be expedited and the interests of the parties will not be prejudiced substantially, any part of the evidence may be received in written form.

TEX. REV. CIV. STAT. ANN. art. 6252—13a, § 14(a) (Vernon Supp. 1978-79).

26. Comptroller of Pub. Accounts, Rule 026.01.03.041, 4 Tex. Reg. at 871.

27. *Id.* Rule 026.01.03.027, 4 Tex. Reg. at 870.

28. *Id.* Rule 026.01.03.028, 4 Tex. Reg. at 870.

29. *Id.*

30. TEX. TAX.-GEN. ANN. art. 1.05 (Vernon 1969).

31. *Id.* art. 20.10.

32. 569 S.W.2d 584 (Tex. Civ. App.—Austin 1978, writ filed). The district court decision in *National Bancshares* was discussed in Rosenbaum, *supra* note 1, at 518-19.

33. TEX. TAX.-GEN. ANN. art. 12.02(1)(b) (Vernon 1969) (article 12.02 sets forth the allocation formula for determining the portion of a corporation's entire taxable capital that

payor" rule for determining whether income from intangible assets such as corporate stock or loans constitute gross receipts from business done in Texas.³⁴ Under the location of payor rule only dividends and interest received from corporations incorporated in Texas constitute gross receipts from business done in Texas. Dividends and interest received from corporations incorporated outside Texas are excluded, even though the corporation may be qualified to do business in Texas.³⁵ At one time the comptroller specifically applied the location of payor rule to bank holding companies and excluded dividends and interest paid to them by their national bank subsidiaries within the state.³⁶

In 1969 the federal statute governing state taxation of national banks³⁷ was amended by Public Law 91-156³⁸ to provide that, for the purpose of any tax law enacted under the authority of any state, a national bank shall be treated as a bank organized and existing under the laws of the state or other jurisdiction within which its principal office is located. The provisions of Public Law 91-156 took effect on January 1, 1973. In 1971 the Texas Legislature enacted House Bill 730,³⁹ which provides that the passage of Public Law 91-156 shall not operate to impose or permit the imposition of any additional tax or taxes upon the "institutions affected thereby" unless (1) the tax or taxes were being imposed prior to January 1, 1971, or (2) such institutions are specifically designated as being subject to such additional tax or taxes, other than the limited sales and use tax, by an act of the legislature passed subsequent to the effective date of Public Law 91-156.

On April 18, 1974, the comptroller published Ruling 80-0.18,⁴⁰ which recognizes that dividends and interest paid by national bank subsidiaries to bank holding companies prior to January 1, 1973, are not gross receipts from business done in Texas. The ruling provides, however, that by virtue of Public Law 91-156, dividends and interest paid on or after January 1, 1973, by a national bank whose principal office is located within Texas are includable in a corporation's gross receipts from business done in Texas within the meaning of article 12.02(1)(b).⁴¹

In *National Bancshares* the district court entered a judgment against the taxpayers that would have required the bank holding companies to include

is subject to the State of Texas's franchise tax, and the gross receipts from the corporation's business done in Texas is one of the variables required by the formula).

34. *Humble Oil & Ref. Co. v. Calvert*, 414 S.W.2d 172, 175 (Tex. 1967).

35. *Id.*

36. Comptroller's Business Tax Ruling .013(2)(t). The comptroller's rulings may be found in the following looseleaf services: TEX. STATE TAX REP. (CCH); STATE & LOC. TAXES (P-H); [TEXAS] INH. EST. & GIFT TAX REP. (CCH).

37. 12 U.S.C. § 548 (1976).

38. Act of Dec. 24, 1969, Pub. L. No. 91-156, §§ 1(a), 2(a), 83 Stat. 434 (codified at 12 U.S.C. § 548 (1976)).

39. 1971 Tex. Gen. Laws ch. 292, art. 7, § 1, at 1206 (codified as a footnote in TEX. TAX.-GEN. ANN. art. 20.02 (Vernon Supp. 1978-79)).

40. On Dec. 31, 1975, ruling 80-0.18 was reissued as Comptroller of Pub. Accounts, Rule 026.02.12.013(2)(t)(1976).

41. TEX. TAX.-GEN. ANN. art. 12.02(1)(b)(iv) (Vernon 1969).

dividends and interest from national bank subsidiaries in their post-January 1, 1973, gross receipts from business done in Texas. The court of civil appeals reversed the district court's decision, holding that the provisions of Public Law 91-156 did not mandate a change in the state taxation of corporations owning national bank stock. Instead, the court viewed the federal legislation as simply allowing the states to treat national banks like state banks for purposes of equal taxation. The court reasoned that the concept of equal taxation of banks was unrelated to the taxation of dividends and interest from national bank stock held by corporate shareholders. Further, the court held that even if Public Law 91-156 was intended to cure unequal franchise tax treatment of corporations owning stock in national banks, House Bill 730 prohibited the change in the tax structure attempted by the comptroller. The court reasoned that corporations owning stock in national banks were "institutions affected" by Public Law 91-156 and that the required inclusion of dividends and interest from those banks in the stockholders' gross receipts from business done in Texas, resulting in substantially increased taxes, constituted the imposition of an additional tax within the meaning of House Bill 730.

The comptroller contended that the construction of House Bill 730 urged by the taxpayers would lead to an unjust result in that it would cause inequality of taxation among bank holding companies and corporations generally. Rejecting this contention, the court reasoned that the comptroller's challenge went to the inherent inequality of the location of payor test and that such a challenge was beyond the comptroller's authority by virtue of a prior supreme court holding⁴² that the location of payor test could be changed only by legislative action.

As was noted in last year's *Survey Article*,⁴³ an amendment to Comptroller's Business Tax Ruling .015(3)(d) affected the method of accounting for a corporation's investment in its subsidiaries.⁴⁴ The ruling presently requires all parent or investor corporations to use the cost method of accounting in calculating and reporting the franchise tax on its investment in subsidiaries or investees, regardless of the accounting method otherwise used by the corporation. Prior to the amendment the ruling provided that whatever method, cost or equity, a parent or investor corporation used to record its investments on its books and records of account had to be followed for franchise tax purposes. The amendment is applicable to any franchise tax report required to be filed after December 13, 1977. Several suits have been filed testing the validity of the ruling as it existed prior to its amendment in 1977.⁴⁵ The suits allege that a corporation should not be required to use the equity method for franchise tax purposes even though that method was used by the corporation for financial accounting pur-

42. *Humble Oil & Ref. Co. v. Calvert*, 414 S.W.2d 172, 180 (Tex. 1967).

43. Rosenbaum, *supra* note 1, at 521-22.

44. Comptroller of Pub. Accounts, Rule 026.02.12.015(3)(d), 2 Tex. Reg. 4625 (1977).

45. See Burke, *supra* note 1, at 441 n.45, and cases cited therein.

poses. In one of those cases, *Ensearch Corp. v. Bullock*,⁴⁶ the district court of Travis County entered judgment for the taxpayer. Accordingly, the corporation's use of the cost method for franchise tax reporting purposes was approved even though the corporation had used the equity method to record its investment in its subsidiaries on its books and records.

The comptroller issued several administrative decisions pertaining to franchise tax treatment during the survey period. These decisions involved the includability of items in taxable capital,⁴⁷ the definition of taxable debt,⁴⁸ the allocation of taxable capital to Texas,⁴⁹ and the requirement that a corporation's franchise tax report must be based on its books and records.⁵⁰

III. SALES AND USE TAXES

In *Lorenzo Textile Mills, Inc. v. Bullock*⁵¹ the court held that article 20.06(D)(1)⁵² is the appropriate statute of limitations when the comptroller issues a notice of deficiency determination in a sales and use tax case. The

46. No. 247,819 (Dist. Ct. of Travis County, 200th Judicial Dist. of Texas, July 26, 1978). This case is being appealed to the Austin court of civil appeals.

47. Comptroller's Administrative Decision No. 7475 (1977) (investment in a "foreign shipping companies" account, which represented the taxpayer's investment in ships sailing under foreign flags, was includable in the taxpayer's surplus for franchise tax purposes; a revaluation account representing an estimate of the excess value of goodwill arising from the value of the taxpayer's patents as well as the overall value of its business was includable in the taxpayer's taxable capital on the ground that it reflected the taxpayer's fiscal condition); Comptroller's Administrative Decision No. 8253 (1977) (a reserve account consisting of the taxpayer's estimated cost of its Christmas gifts to employees was a proper deduction from taxable capital to the extent of the actual expenses charged off on the taxpayer's year-end statement); Comptroller's Administrative Decision No. 9867 (1978) (a reserve account which represented an estimate of the corporation's possible future federal income tax liability represented a contingent liability not yet due and was therefore properly includable as part of the corporation's taxable capital).

48. Comptroller's Administrative Decision No. 9070 (1978) (a convertible debenture having a due date of more than one year from the date of issuance was includable as taxable debt for periods prior to May 1, 1973, pursuant to 1959 Tex. Gen. Laws ch. 1, at 187).

49. Comptroller's Administrative Decision No. 8999 (1977) (where the taxpayer's portion of an interstate shipment was wholly within Texas, the freight revenues earned thereon were properly considered as receipts from services performed within Texas pursuant to TEX. TAX.-GEN ANN. art. 12.02(1)(b)(ii) (Vernon 1969)); Comptroller's Administrative Decision No. 7606 (1978) (insurance proceeds received on fire and casualty policies for the repair or replacement of damaged or destroyed property are not receipts from business done in Texas because the proceeds do not represent sales or other business receipts); Comptroller's Administrative Decision No. 8732 (1978) (although a parent corporation accounts for its investments in its subsidiary on the equity basis on its books and records, the dividend from the subsidiary cannot be considered as a Texas receipt until the dividend is lawfully declared by the subsidiary); Comptroller's Administrative Decision No. 9197 (1978) (a corporation must follow the procedures set forth in Comptroller of Pub. Accounts, Franchise Tax Rule 026.02.12.003 before its petition for an alternate allocation formula will be considered).

50. Comptroller's Administrative Decision No. 10085 (1978) (pursuant to Comptroller of Pub. Accounts, Franchise Tax Rule 026.02.12.001 & .015, the books and records that a corporation must use in filing its franchise tax report are its general and special journals and ledgers and not its working papers and financial statements); *accord*, Comptroller's Administrative Decision No. 9830 (1978).

51. 566 S.W.2d 107 (Tex. Civ. App.—Austin 1978, no writ). The district court decision was discussed in Rosenbaum, *supra* note 1, at 527-28.

52. TEX. TAX.-GEN. ANN. art. 20.06(D)(1) (Vernon 1969).

statute provides that "[e]very notice of a deficiency determination shall be personally served or mailed within four years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined or within four years after the return is filed, whichever period expires the later."⁵³ The periods for which deficiencies were assessed by the comptroller extended from April 1, 1966, through December 31, 1973. The comptroller gave the taxpayer notice of the alleged deficiencies on April 29, 1974. The taxpayer paid all taxes, penalty, and interest due for the periods after 1970, but paid the amounts due for the periods prior to that time under protest.

The issue presented to the court of civil appeals was whether the taxes were barred after four years under article 20.06(D)(1) or were not barred due to the subsequent enactment of article 1.045(A).⁵⁴ The latter article sets forth a general statute of limitations of seven years in tax assessment cases and provides that "[i]n the case of gross error in information reported in a return that would increase the amount of tax payable by twenty-five percent (25%) or more . . . the tax may be assessed and collected . . . at any time."⁵⁵ The taxpayer countered that the provisions of article 1.045(A) did not affect the four-year limitations period imposed by article 20.06(D)(1), asserting that the unextended four-year limitations period was confirmed by article 1.045(B),⁵⁶ which specifically provides a four-year statute of limitations for sales and use taxes.

Sustaining the taxpayer's position, the court held that article 1.045(A) and article 1.045(B) stood in harmony with article 20.06(D)(1) and that it was the legislative intent to achieve such harmony and not to repeal or destroy article 20.06(D)(1) by implication. The decision also noted that by including the introductory clause of article 1.045(A), "[e]xcept where a shorter period of time is provided in this Title,"⁵⁷ the legislature recognized the continued validity of article 20.06(D)(1). Further, the court reasoned that article 1.045(B), which reiterates the four-year period as to sales and use taxes, preserved the limitations period established by article 20.06(D)(1).

The decision of the Texas Supreme Court in *Bullock v. Lone Star Gas Co.*⁵⁸ considered whether the use tax exemption of article 20.04(G)(3)(a)⁵⁹ applied to the use and storage of pipeline materials. Article 20.04(G)(3)(a) exempts from the use tax the use in Texas of tangible personal property acquired outside the state and moved into the state for use as a licensed and certificated carrier of persons or property. In 1972 the Travis County

53. *Id.*

54. *Id.* art. 1.045.

55. The taxpayer in *Lorenzo* admitted that the error in the reported tax would amount to an increase in the tax of 25% or more. 566 S.W.2d at 110.

56. TEX. TAX.-GEN. ANN. art. 1.045(B) (Vernon 1969).

57. *Id.* art. 1.045(A).

58. 567 S.W.2d 493 (Tex. 1978), *cert. denied*, 47 U.S.L.W. 3369 (U.S. Nov. 27, 1978).

59. TEX. TAX.-GEN. ANN. art. 20.04(G)(3)(a) (Vernon 1969).

district court held in *Explorer Pipeline Co. v. Calvert*⁶⁰ that article 20.04(G)(3)(a) exempted pipe and other component parts purchased outside the state and brought into the state for incorporation into a pipeline. The comptroller did not appeal the decision and granted use tax refunds to other pipeline carriers that had made similar purchases of pipeline materials.⁶¹ The comptroller subsequently changed his policy and issued a sales tax ruling providing that items of tangible personal property that are to be assembled into carriers are not exempted by article 20.04(G)(3)(a) because such items are not licensed and certificated carriers when they enter the state.⁶²

In *Lone Star Gas* the taxpayer, which held a permit from the Texas Railroad Commission, was engaged in the business of gathering, transporting, and selling natural gas. During 1972 the taxpayer decided to construct an intrastate pipeline in Texas. Portions of the pipe incorporated into the pipeline were purchased from the Crispin Corporation of Houston, Texas, whose major business activity was brokering foreign steel products. Pursuant to its contract with the taxpayer, Crispin arranged for the pipe to be manufactured according to the taxpayer's specifications by mills in France and Italy. Crispin purchased the pipe from these foreign mills and sold it to the taxpayer. The taxpayer employed an independent firm to inspect the pipe during its production, manufacture, and shipment to Texas. Title passed to the taxpayer when the pipe was loaded for shipment in Europe, but Crispin was responsible for transportation of the pipe from Europe to a commercial pipe treatment facility near Houston, Texas. After the pipe arrived in Houston, it was taken to a storage yard, where it remained for periods as long as sixty days. The pipe then was moved to the yard of the firm that coated the pipe for corrosion protection. Thereafter, the pipe was loaded on the taxpayer's trucks and shipped to West Texas.

The court of civil appeals held that the pipe was exempt from the use tax pursuant to article 20.04(G)(3)(a). On appeal to the Texas Supreme Court the comptroller contended that the transaction was subject to state and local sales and use taxes upon each of three statutory bases: (1) as a sale

60. No. 193,423 (Dist. Ct. of Travis County, 126th Judicial Dist. of Texas, Nov. 16, 1972).

61. Defendant's Answers and Responses to Plaintiff's Request for Admissions and Written Interrogatories, Admission No. 19, *Bullock v. Lone Star Gas Co.*, 567 S.W.2d 493 (Tex. 1978), *cert. denied*, 47 U.S.L.W. 3369 (U.S. Nov. 27, 1978).

62. See Comptroller of Pub. Accounts, Rule 026.02.20.17 (1975), which provides:

Carrier devices such as ships and aircraft, which are acquired outside this state and are moved into this state for use as a licensed and certificated carrier of persons or property, are exempt from the Use Tax. Such carriers are entitled to this exemption only if acquired outside Texas. Repair or replacement parts which are acquired outside this state and actually affixed in this state to a self-propelled vehicle which is a licensed and certificated carrier of persons or property are exempt from the Use Tax. Trailers, barges and semitrailers are not considered to be self-propelled vehicles. Taxable items which are to be assembled into carriers are not exempt under the provisions of Article 20.04(G)(3)(a) as such items are not licensed and certificated carriers when they enter the state.

under articles 20.02⁶³ and 20.01(K);⁶⁴ (2) as a use under articles 20.03⁶⁵ and 20.01(R);⁶⁶ and (3) as a storage under articles 20.03⁶⁷ and 20.01(N).⁶⁸ The taxpayer argued that neither the sale nor the storage was a taxable event and that any use of the pipe in Texas was exempt pursuant to article 20.04(G)(3)(a). The supreme court rejected Lone Star's contentions and held that article 20.03 imposes a separate tax on the use of property, the storage of property, and any other consumption of property. The court reasoned that article 20.04(G)(3)(a) exempts solely the use of certain property from tax and does not apply to the separate tax on the storage of such property.⁶⁹ Accordingly, the court determined that the pipe was subject to state and local use taxes.

There are several questionable aspects of the *Lone Star Gas* decision. First, the court's reasoning that article 20.03 imposes separate taxes on the use, storage, and other consumption of property and that article 20.04(G)(3)(a) does not exempt the latter two events from taxation is subject to criticism. Article 20.01(R)⁷⁰ defines the word "use" to include "the exercise of any right or power over tangible personal property incident to the ownership of that tangible personal property." Since the keeping or storage of property constitutes the exercise of a right or power over such property, such activity would constitute a use pursuant to the broad definition contained in article 20.01(R). Accordingly, any storage of the pipe within the meaning of article 20.01(N) arguably constitutes a use of the pipe as defined in article 20.01(R), which would be exempted from the use tax by article 20.04(G)(3)(a).

Another questionable aspect of the *Lone Star Gas* decision is the court's effort to buttress its reasoning by relying on United States Supreme Court and state court decisions that have determined whether state sales and use taxes imposed on tangible personal property constitute an unconstitutional burden on interstate commerce.⁷¹ The court's reasoning indicates that the court believes that article 20.04(G)(3)(a) is intended to exempt only items of tangible personal property that are immune from state taxation due to the commerce clause of the United States Constitution.⁷² Such conclusion, if intended by the court, would make article 20.04(G)(3)(a) totally super-

63. TEX. TAX.-GEN. ANN. art. 20.02 (Vernon Supp. 1978-79).

64. *Id.* art. 20.01(K) (Vernon 1969).

65. *Id.* art. 20.03.

66. *Id.* art. 20.01(R).

67. *Id.* art. 20.03.

68. *Id.* art. 20.01(N).

69. In its motion for rehearing Lone Star vigorously objected to the court's holding that there was a storage of the pipe. Lone Star asserted that it was using the pipe from the time it took title in Europe and that such use was exempt pursuant to art. 20.04(G)(3)(a). Respondent's Motion for Rehearing at 1-5, *Bullock v. Lone Star Gas Co.*, 567 S.W.2d 493 (Tex. 1978), *cert. denied*, 47 U.S.L.W. 3369 (U.S. Nov. 27, 1978).

70. TEX. TAX.-GEN. ANN. art. 20.01(R) (Vernon 1969).

71. The cases relied upon were *Pacific Tel. & Tel. Co. v. Gallagher*, 306 U.S. 182 (1939); *Southern Pac. Co. v. Gallagher*, 306 U.S. 167 (1939); *American Airlines, Inc. v. State Bd. of Equalization*, 216 Cal. App. 2d 180, 30 Cal. Rptr. 590 (Dist. Ct. App. 1963); *Northern Natural Gas Co. v. Lauterbach*, 251 Iowa 885, 100 N.W.2d 908 (1960).

72. U.S. CONST. art. I, § 8, cl. 3.

fluous because article 20.04(C)⁷³ already exempts from Texas sales and use taxes items of tangible personal property that the state is prohibited from taxing under the United States Constitution.

Two decisions during the survey period interpreted article 20.01(T),⁷⁴ which governs the sales and use tax treatment of repairmen and contractors. In *Firestone Tire & Rubber Co. v. Bullock*⁷⁵ the Texas Supreme Court examined the issue of whether a taxpayer who installs shock absorbers in customers' automobiles and charges a lump-sum price that includes both parts and labor is a "repairman" for sales tax purposes. Article 20.01(T) defines a contractor or repairman as any person who performs any repair services upon tangible personal property or who performs any improvement upon real estate, and who, as a necessary and incidental part of performing such services, incorporates tangible personal property belonging to him into the property being so repaired or improved.⁷⁶ Under repair contracts that specify a lump-sum price covering both the services and the necessary incidental material, the repairman is considered to be the ultimate consumer of the tangible personal property furnished by him if he incorporates it into the customer's property as a necessary and incidental part of performing the repair services. Since the repairman is considered the ultimate consumer of this property, the repairman is not required to collect any tax from the customer on the lump-sum charge or any portion thereof.⁷⁷

In the *Firestone* case Firestone paid a retail sales tax on approximately one-half of the shock absorbers in question at the time it purchased them at retail from local suppliers. Firestone bought the remainder in its capacity as a wholesaler, and taxes were paid to the comptroller on these shock absorbers as they were sold through Firestone's repair shops. Firestone did not sell shock absorbers over the counter at retail; instead, it made installations in customers' vehicles for a lump-sum price that included all the costs of materials and labor. At stake in this case was the difference between the amount of taxes Firestone had already paid to retailers and directly to the comptroller and the amount the comptroller found to be due by treating Firestone's lump-sum installations as retail sales of shock absorbers.

Firestone contended that the installation of shock absorbers was necessary and incidental to the repair of automobiles and that it was not required to charge and collect sales taxes on the lump-sum price. The comptroller argued that Firestone's installation was merely incidental to the sale of shock absorbers and that Firestone was responsible for charging and collecting sales taxes from its customers based on the total price of the installation.

The Texas Supreme Court agreed with the comptroller's contention that

73. TEX. TAX.-GEN. ANN. art. 20.04(C) (Vernon 1969).

74. *Id.* art. 20.01(T).

75. 573 S.W.2d 498 (Tex. 1978).

76. TEX. TAX.-GEN. ANN. art. 20.01(T) (Vernon 1969).

77. *Id.* See also Comptroller of Pub. Accounts, Rule 026.02.20.011 (1969).

experience, special skill, and knowledge are negligible factors in the installation of shock absorbers and that Firestone did not come within the statutory definition of a repairman when performing a simple shock absorber installation. The stipulated findings indicated, however, that on some occasions customers brought automobiles to Firestone's shops, described general problems with respect to the automobile, and asked Firestone to make repairs. New shock absorbers sometimes were installed during the course of such repair work. The court inferred from the stipulations that in certain instances Firestone was expected to rely upon its experience and to exercise skill and judgment in analyzing the problem and in furnishing necessary repair service. The court also inferred that replacement of shock absorbers would not be the full extent of repair in many of these transactions. Thus, in instances where work other than replacement of shock absorbers was performed, the replacement of shock absorbers could well be necessary and incidental to the repair service rendered. From this factual record the court determined that Firestone replaced shock absorbers on customers' cars in the performance of lump-sum general repair services and that Firestone incorporated its own shock absorbers into the vehicles being repaired as a necessary and incidental part of performing the repair service. Thus, Firestone was placed within the statutory definition of repairman and was relieved from charging and collecting sales taxes on the lump-sum repair price.

The definition of contractor as set forth in article 20.01(T) was considered in *Brazos Concrete Products, Inc. v. Bullock*.⁷⁸ Brazos manufactured prestressed and precast concrete items used in the construction of highway bridges and buildings. At issue was the applicability of sales and use taxes to equipment used by Brazos in manufacturing concrete products for sale to general contractors who incorporated the concrete products into highways pursuant to contracts with the Texas Department of Highways and Public Transportation. Article 20.04(Y)⁷⁹ exempts from tax items of tangible personal property used by a contractor in the performance of a contract for the improvement of realty if the contract is with certain entities that are exempt from sales and use taxes, including the Department of Highways and Public Transportation.⁸⁰ Brazos contended that its equipment was exempt from tax under this statute. The court found that Brazos neither in-

78. 567 S.W.2d 877 (Tex. Civ. App.—Eastland 1978, no writ).

79. TEX. TAX.-GEN. ANN. art. 20.04(Y) (Vernon 1969) provides:

(Y) Contracts with Exempt Organizations. There are exempted from the computation of the amount of taxes imposed by this Chapter, the receipts from the sale, lease or rental of any tangible personal property to, or the storage, use or other consumption of tangible personal property by, any contractor for the performance of a contract for the improvement of realty for an exempt organization as defined in Section 20.04(H) of this Chapter or otherwise exempt from the taxes imposed by this Chapter to the extent of the value of the tangible personal property so used or consumed or both in the performance of such contract.

80. The Texas Department of Highways and Public Transportation is exempt from sales tax pursuant to TEX. TAX.-GEN. ANN. art. 20.04(H)(3) (Vernon Supp. 1978-79), which exempts the State of Texas and its unincorporated agencies and instrumentalities.

corporated the concrete products into the realty nor contracted with a tax exempt organization to incorporate such products into the realty. Instead, Brazos contracted with a private, taxpaying corporation to deliver the products to the job site, and therefore, was a supplier rather than a contractor or subcontractor.

In *Houston Natural Gas Corp. v. Southwestern Apparel, Inc.*⁸¹ eleven plaintiff corporations sought, individually and as representatives of a class of those similarly situated, to recover state sales taxes allegedly collected from them upon their purchases of natural gas and electricity. The plaintiffs maintained that portions of their gas and electricity purchases were exempt from taxation under article 20.04(R)⁸² because such portions were used in connection with manufacturing as opposed to commercial or residential use. The plaintiffs contended that Comptroller's Ruling 95-0.07,⁸³ which governs exemption certificates, and Comptroller's Ruling 95-0.12, which governs natural gas and electricity,⁸⁴ were ultra vires or otherwise illegal.

Comptroller's Ruling 95-0.12 sets forth the predominant use rule, which states that natural gas or electricity measured by a single meter and used for both exempt and nonexempt purposes during a regular monthly billing period shall be either totally exempt or nonexempt for the billing period, depending on the predominant use of such natural gas or electricity. The court upheld the validity of the predominant use rule after finding that the rule was in harmony with the general objectives of the sales and use tax statutes, had been found to be workable through many years of application, and was used only when there was no practical way to determine what part of the gas or electricity was used in a taxable manner.

Comptroller's Ruling 95-0.07, which also was challenged by the plaintiffs, places an affirmative duty on any party claiming an exemption from sales and use taxes to furnish an exemption certificate to the seller. The plaintiffs argued that there is nothing in article 20.04(R) that expressly or impliedly gives the comptroller authority to impose burdens, conditions, and restrictions that are in excess of or inconsistent with the statutory provisions. Rejecting this contention, the court relied on article 20.11,⁸⁵ which authorizes the comptroller to promulgate rules and regulations relating to the administration and enforcement of the Limited Sales, Excise and Use Tax Act. The court reasoned that administration and enforcement of the sales and use tax statutes would be extremely difficult, if not impossible, without the use of exemption certificates. Since the ruling's provisions were found to be in harmony with the general objectives of the statute, the

81. 558 S.W.2d 950 (Tex. Civ. App.—Austin 1977, writ dismissed).

82. TEX. TAX.-GEN. ANN. art. 20.04(R) (Vernon Supp. 1978-79).

83. On Dec. 31, 1975, Comptroller's Sales Tax Ruling 95-0.07 was recodified as Comptroller of Pub. Accounts, Rule 026.02.20.007 (1975).

84. On Dec. 31, 1975, Comptroller's Sales Tax Ruling 95-0.12 was recodified as Comptroller of Pub. Accounts, Rule 026.02.20.015 (1975).

85. TEX. TAX.-GEN. ANN. art. 20.11 (Vernon 1969).

court concluded that the comptroller had not exceeded his rule-making powers.

Transactions that are subject to the state sales tax also give rise to local tax liability if they are consummated in a city that has adopted a local sales and use tax pursuant to the Local Sales and Use Tax Act.⁸⁶ Under that Act all intrastate retail sales are consummated at the place of business of the retailer. If the retailer has more than one place of business in the state, the place at which its sales are consummated is the place where the purchaser takes possession of the property. If the retailer delivers the property, however, the sale is consummated at the place of business from which it was delivered.⁸⁷ In *Dunigan Tool & Supply Co. v. Bullock*⁸⁸ the district court of Travis County considered the application of the Local Sales and Use Tax Act to a retailer who had more than one place of business within the state. The first issue that the court addressed involved certain sales of oil field pipe, casing, rods, and other tubular goods from Dunigan's inventory located within bonded, unrelated trucking yard facilities where Dunigan leased storage space on a month-to-month basis.⁸⁹ The tubular goods at the storage facilities were segregated and identifiable as Dunigan's inventory.⁹⁰ Although Dunigan did not keep full-time personnel at the storage facilities, the facilities were open twenty-four hours a day, and Dunigan's employees or representatives periodically entered the premises to conduct inspections and inventories. In addition, Dunigan sometimes brought customers to these storage facilities to let them examine the goods.

On the basis of his own administrative ruling,⁹¹ the comptroller asserted that trucking yard facilities in which Dunigan leased storage space did not constitute "places of business." Since neither delivery nor transfer of possession was made from any of Dunigan's places of business, the comptroller asserted that, for local tax purposes, the sales of pipe were deemed to be consummated at Dunigan's place of business in Texas to which the person

86. TEX. REV. CIV. STAT. ANN. art. 1066c (Vernon Supp. 1978-79).

87. *Id.* § 6(B).

88. No. 265,198 (Dist. Ct. of Travis County, 53d Judicial Dist. of Texas, Aug. 31, 1978). The case is being appealed to the Austin court of civil appeals.

89. In addition to its leased facilities, Dunigan also maintained a number of retail stores within the state. Findings of Fact and Conclusions of Law at 2, *Dunigan Tool & Supply Co. v. Bullock*, No. 265,198 (Dist. Ct. of Travis County, 53d Judicial Dist. of Texas, Aug. 31, 1978).

90. *Id.* at 3.

91. Comptroller of Pub. Accounts, Rule 026.02.22.004(2)(a) (1975) provides:

For the purpose of the *local* sales tax, it is immaterial that title or possession of the taxable items sold, leased or rented passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located. The term "place of business" means any regularly established office or location within the State of Texas operated by the vendor for the purpose of selling or taking orders for taxable items. The term "place of business" does not include a warehouse or storage location from which sales are not regularly made. Under the local sales tax, where the retailer has only one place of business, all retail sales, leases or rentals, except sales of natural gas or electricity, are consummated at that place of business unless the taxable item is delivered by the retailer or his agent to an out-of-state destination or to a carrier for delivery to an out-of-state destination.

making the sale or taking the sales order was assigned.⁹² The district court rejected the comptroller's contention on two grounds. First, the district court made a fact finding that the pipe facilities were Dunigan's "places of business."⁹³ Pursuant to that finding, sales of tubular goods were deemed to be consummated for local tax purposes at the yard where the purchaser took possession or the yard from which the goods were delivered by Dunigan to the purchaser.⁹⁴ Second, the court stated that since the purchaser took possession of the goods at the leased facilities, the sales were consummated at such facilities for local tax purposes regardless of whether they constituted "places of business." To the extent that the facilities were located outside of local taxing jurisdictions, Dunigan owed no local sales tax. To the extent that sales were made from Dunigan's inventory in leased storage facilities that were located within the limits of a city that had adopted the Local Sales and Use Tax Act, Dunigan owed local sales taxes.⁹⁵

The second issue in *Dunigan* involved sales from a manufacturer or mill located within Texas. Dunigan had arranged for goods to be shipped directly to the customer from the in-state facility of the original manufacturer. The court found that section 6(B)(1) of the Local Sales and Use Tax

92. *Id.* Rule 026.02.22.004(2)(d) provides:

In the event the retailer has more than one place of business in the State but neither delivery nor transfer of possession of the taxable item is made from or at any of the retailer's places of business, the sale is consummated at the retailer's place of business in Texas to which the person making the sale or taking the order for the taxable items is assigned. Sales made or orders taken by a salesperson not assigned to any of the retailer's places of business in Texas will be treated as sales by itinerant vendors which sales are consummated within the city where the order is taken.

93. Findings of Fact and Conclusions of Law at 3. This point was elaborated on by the district court in conclusion of law number 5, which provided:

A "place of business" is not defined by either the State Act or the Local Act. The Comptroller's determination of a place of business (whatever may be the applicability in a different context) is not controlling here where a plain reading of the statute clearly sets forth the place where a sale is consummated with respect to Plaintiff's inventory sales. The fact that Plaintiff did not obtain a Sales Tax Permit for these pipe facilities has no bearing on the imposition of the place where a sale is consummated for purposes of the Local Act since the purpose for requiring a Sales Tax Permit is merely administrative.

Id. at 6.

94. Comptroller of Pub. Accounts, Rule 026.02.22.004(2)(c) (1975).

95. Findings of Fact and Conclusions of Law at 6-7. The district court's conclusion was based on TEX. REV. CIV. STAT. ANN. art. 1066c, § 6(B)(1) (Vernon Supp. 1978-79) (emphasis added), which provides in part:

If the retailer has more than one place of business in the State, the place or places at which retail sales, leases, and rentals are consummated shall be the retailer's *place or places* where the purchaser or lessee takes possession and removes from the retailer's premises the articles of tangible personal property, or if the retailer delivers the tangible personal property to a point designated by the purchaser or lessee, then the sales, leases, or rentals are consummated at the retailer's place or places of business from which tangible personal property is delivered to the purchaser or lessee.

The district court concluded that the pipe facilities were Dunigan's "place or places" where the sales were consummated. In so holding, the court rejected the comptroller's assertion that the phrase "retailer's place or places" contained in art. 1066c, § 6(B)(1) should be read "place or places of business."

Act⁹⁶ was silent with respect to where the sale was consummated since the manufacturer's mill or mill inventory was not Dunigan's "place." Therefore, pursuant to section 6(A) of the Local Sales and Use Tax Act,⁹⁷ the court was required to look to the state sales and use tax statutes. Relying on judicial precedents,⁹⁸ the district court held that under the state sales and use tax statutes a sale takes place when the goods are segregated in contemplation of a transfer of either title or possession of the goods to a purchaser.⁹⁹ Since segregation of the tubular goods occurred at the manufacturer's mill or at the location of the manufacturer's mill inventory within Texas, Dunigan owed local sales tax only to the extent that the mill or mill inventory was located within a city that had adopted the Local Sales and Use Tax Act.¹⁰⁰ In so holding, the district court rejected the comptroller's contention that the sales were consummated for local tax purposes at Dunigan's place of business to which the employee who made the sale or took the order was assigned.¹⁰¹

The third issue in the *Dunigan* case involved sales to customers who placed orders at one of Dunigan's offices in a city that had adopted the Local Sales and Use Tax Act where the ordered goods were shipped directly to the customer from an out-of-state facility of an independent manufacturer. The comptroller contended that this type of transaction gave rise to a sale for local sales and use tax purposes, which was deemed to be consummated where the order was placed.¹⁰² Rejecting the comptroller's position, the court concluded that the sale occurred outside of Texas. When a customer orders goods through a Texas vendor that are shipped directly to the customer by an out-of-state manufacturer, the goods are segregated in contemplation of transfer of possession at the out-of-state manufacturer's mill or mill stock inventory site. As a result, the sales are consummated at the out-of-state mills and are not subject to state and local sales taxes. Consequently, the court concluded that the only tax that could be imposed in connection with the transaction was a use tax.¹⁰³ The applicability of the local use tax depends upon the point at which the purchaser stores, uses, or consumes the goods.¹⁰⁴ The point at which the order is taken therefore has no bearing on the determination of whether the local tax is owing. Accordingly, the court concluded that a local use tax would be due on transactions in this category only to the extent that the destination or delivery points were within a city that had adopted the Local Sales and Use Tax Act. In all other instances the local use tax would not apply

96. TEX. REV. CIV. STAT. ANN. art. 1066c, § 6(B)(1) (Vernon Supp. 1978-79).

97. *Id.* § 6(A) (applicable provisions of state tax statutes apply to collection of local tax, except as modified by the Local Sales and Use Tax Act).

98. *Bullock v. Lone Star Gas Co.*, 567 S.W.2d 493 (Tex. 1978); *Gifford-Hill & Co. v. State*, 442 S.W.2d 320 (Tex. 1969).

99. Findings of Fact and Conclusions of Law at 7.

100. *Id.* at 7-8.

101. Comptroller of Pub. Accounts, Rule 026.02.22.004(2)(d) (1975).

102. *Id.*

103. Findings of Fact and Conclusions of Law at 7.

104. Comptroller of Pub. Accounts, Rule 026.02.22.005(1) (1975).

since the delivery point was outside a local taxing jurisdiction.¹⁰⁵

The final issue in *Dunigan* involved sales of supplies that were not segregated until they were used at a delivery site located outside of a local taxing jurisdiction.¹⁰⁶ Generally *Dunigan's* customers would order drilling mud and drilling bits based upon a predetermined estimate. The customers contacted mud and bit companies directly for delivery of various grades of mud and bits to the well sites. The companies would normally deliver a greater quantity than was necessary, and any unused supplies at the time of the completion of the well would be returned at no charge. The companies would then bill *Dunigan* for the supplies that were actually used, and *Dunigan* in turn would bill its customers. *Dunigan* generally had no knowledge of these sales until after the materials were used. The court concluded that the Local Sales and Use Tax Act was silent with respect to the place at which the sales were consummated since the delivery points and the use of the materials were at well sites outside of city limits, and the goods were delivered directly to *Dunigan's* customers by the manufacturer or processor of the items. Based on the state sales and use tax statutes, the court ruled that a segregation in contemplation of transfer of title to or possession of the mud and bits occurred at the drill site. Since the sales were consummated for local tax purposes at well sites situated outside of local taxing jurisdictions, no local sales or use taxes were due.¹⁰⁷ If *Dunigan* is upheld on appeal, it will result in the reversal of several of the comptroller's administrative rulings relating to the administration of the Local Sales and Use Tax Act.¹⁰⁸ Consequently, the appellate decisions in the *Dunigan* case will be of great significance.

The legislature amended article 20.04(R)¹⁰⁹ of the Limited Sales, Excise and Use Tax Act to provide that gas and electricity used for residential purposes are exempt from state sales and use taxes. The amendment expanded the definition of "residential use" to include a multi-family apartment or housing complex or building or portion thereof occupied as a home or residence.¹¹⁰ The Local Sales and Use Tax Act was amended to provide that until October 1, 1979, gas and electricity used for residential purposes are subject to local tax in cities imposing a local sales and use tax unless such sales are exempted by the city. Effective October 1, 1979, sales of gas and electricity for residential use are exempt from the one percent local tax unless prior to May 1, 1979, the governing body of the city votes to continue the tax.¹¹¹ An opinion of the attorney general¹¹² concluded

105. Findings of Fact and Conclusions of Law at 7-8.

106. *Id.* at 4.

107. *Id.* at 7-8.

108. See notes 91, 101-02 *supra* and accompanying text.

109. TEX. TAX.-GEN. ANN. art. 20.04(R) (Vernon Supp. 1978-79).

110. *Id.*

111. The local sales and use tax changes were accomplished through the addition or amendment of the following statutory provisions: TEX. REV. CIV. STAT. ANN. art. 1066c, § 2(B) (Vernon Supp. 1978-79) (the sales tax portion of any local sales and use tax is imposed at the rate of one percent on the receipts from sales at retail of gas and electricity for residential purposes within a city imposing a local tax); *id.* § 2(L) (providing a procedure for

that, pursuant to these amendments to the Local Sales and Use Tax Act, cities that first adopt the Local Sales and Use Tax Act after October 1, 1979, may not impose the local tax on the residential use of gas and electricity.

The comptroller issued numerous administrative decisions regarding sales and use taxes during the survey period, most of which are of only minor significance.¹¹³ These decisions involved local sales and use taxes,¹¹⁴ classification of items as tangible personal property or improvements to realty,¹¹⁵ the occasional sale exemption,¹¹⁶ miscellaneous exemp-

adding the tax on gas and electricity for residential use to the sales price); *id.* § 4(A) (effective Oct. 1, 1979, sales of gas and electricity for residential use are exempt from the one percent local tax unless prior to May 1, 1979, the governing body of the city, by majority vote of the membership of the governing body, votes to continue the tax; at any time before or after Oct. 1, 1979, the governing body of a city adopting a local sales and use tax may exempt sales and use of gas and electricity for residential use from taxation or reimpose the tax thereon); *id.* § 4(D) (in every city adopting a local sales and use tax there is imposed an excise tax on the storage, use or other consumption within the city of gas and electricity for residential use at the rate of one percent of the sales price, or in the case of leases and rentals, one percent of the lease or rental price); *id.* § 5 (amended to provide for the administration, collection, and enforcement by the comptroller of the local tax on gas and electricity for residential use); *id.* § 6(C)(1) (amended to exclude from the Local Sales and Use Tax Act the state sales and use tax exemption contained in TEX. TAX.-GEN. ANN. art. 20.04(R) (Vernon Supp. 1978-79) for gas and electricity sold for residential use); TEX. TAX.-GEN. ANN. art. 20.01(AA) (Vernon Supp. 1978-79) (the definitions and other provisions of the Limited Sales, Excise and Use Tax Act relating to collection, administration, enforcement, and sales tax permits shall apply to sellers and purchasers whose sales and purchases are exempt from the taxes imposed by the Limited Sales, Excise and Use Tax Act, but who are subject to the taxes imposed by a city under the Local Sales and Use Tax Act).

112. TEX. ATT'Y GEN. OP. No. H-1282 (1978).

113. Summaries of comptroller's administrative decisions may be found in the following looseleaf services: TEX. STATE TAX REP. (CCH); STATE & LOC. TAXES (P-H).

114. Comptroller's Administrative Decision No. 8910 (1978) (where property was purchased under a direct-pay permit within a local taxing jurisdiction and shipped by the seller to the purchaser's facility that was not in a local taxing jurisdiction, local tax was not due by virtue of the purchaser's taking possession of the goods outside a local taxing jurisdiction); Comptroller's Administrative Decision No. 8733 (1978) (where tangible personal property is purchased in a local taxing jurisdiction under a direct-pay permit and is stored or kept at the purchaser's place of business within a local taxing jurisdiction before being used at a job site outside the local taxing jurisdiction, local tax becomes due to the jurisdiction where the property was stored or kept pursuant to TEX. REV. CIV. STAT. ANN. art. 1066c, § 6(B)(3) (Vernon Supp. 1978-79)); Comptroller's Administrative Decision No. 9790 (1978) (where the taxpayer purchased tangible personal property from out-of-state vendors who shipped the items directly to the taxpayer's plant, which was not in a local taxing jurisdiction, the purchases were not subject to local use tax).

115. Comptroller's Administrative Decision No. 8925 (1977) (a taxpayer who fabricated and installed metal framework and ornamental ironwork on structures was improving realty and thus was a contractor pursuant to TEX. TAX.-GEN. ANN. art. 20.01(T) (Vernon 1969)); Comptroller's Administrative Decision No. 9024 (1977) (a taxpayer who manufactured custom-made draperies and installed them into a customer's property was a contractor pursuant to TEX. TAX.-GEN. ANN. art. 20.01(T) (Vernon 1969)).

116. Comptroller's Administrative Decision No. 8517 (1978) (the sale of 82% of the corporation's assets to another corporation was a transfer of "substantially all the property held or used" by the selling corporation within the definition of an occasional sale contained in TEX. TAX.-GEN. ANN. art. 20.01(F)(3) (Vernon 1969); if a selling corporation and a buying corporation are wholly owned by a grandparent corporation, the "real or ultimate ownership" of property sold between the two corporations is "substantially similar" both before and after the sale for purposes of the definition of occasional sale contained in TEX. TAX.-GEN. ANN. art. 20.01(F)(3) (Vernon 1969)); Comptroller's Administrative Decision No. 9121

tions,¹¹⁷ and various other matters.¹¹⁸

(1978) (the sale of almost all the operating assets of a business to several persons with the retention of several assets by the seller did not qualify as an occasional sale pursuant to TEX. TAX.-GEN. ANN. art. 20.01(F)(2) (Vernon 1969) because all the operating assets were not sold to one purchaser); Comptroller's Administrative Decision No. 8627 (1978) (sales of taxable items only are included in applying the occasional sale exemption contained in TEX. TAX.-GEN. ANN. art. 20.04(I) (Vernon 1969)); Comptroller's Administrative Decision No. 10187 (1978) (where a company made two wholesale sales of tangible personal property within 12 months before or after making two retail sales of tangible personal property, it made more than two sales of taxable items within the meaning of TEX. TAX.-GEN. ANN. art. 20.01(F)(1) (Vernon 1969) and did not qualify for the occasional sale exemption on its two retail sales); Comptroller's Administrative Decision No. 9560 (1978) (the sale of an oil rig and related accessories in a single transaction by a company that did not hold a sales tax permit in Texas or in any other state during the 12-month period before and after the sale and which during this period made only one other sale of tangible personal property was an occasional sale pursuant to TEX. TAX.-GEN. ANN. art. 20.01(F)(1) (Vernon 1969)); Comptroller's Administrative Decision No. 10356 (1978) (where a seller sold part of the operating assets of its business to one purchaser and the remainder of the assets by a separate sale to another purchaser, the seller did not make an occasional sale pursuant to TEX. TAX.-GEN. ANN. art. 20.01(F) (Vernon 1969) and Comptroller's Sales Tax Ruling .036 because it did not sell the entire operating assets of its business in one transaction to one purchaser).

117. Comptroller's Administrative Decision No. 8823 (1978) (where a lump-sum contractor for the improvement of realty makes a tax-free purchase of equipment that is used on both exempt and nonexempt projects, the equipment is taxable based on the amount it depreciated during the period of time it was used in a nonexempt manner); Comptroller's Administrative Decision No. 7867 (1978) (tangible personal property that was purchased outside of Texas for use at an out-of-state plant, used there for a period of one year, and transferred for use in Texas only after the out-of-state plant was closed was not purchased "for use in Texas" and thus was not subject to Texas use tax under TEX. TAX.-GEN. ANN. art. 20.03 (Vernon 1969)); Comptroller's Administrative Decision No. 8447 (1978) (beer, which was originally purchased tax-free for resale but later used for promotional purposes or as a political contribution, is taxable based on its original purchase price); Comptroller's Administrative Decision No. 8784 (1978) (the purchase of an aircraft by a Texas resident who uses it to obtain an instrument rating is not exempt under the flight training exemption provided in TEX. TAX.-GEN. ANN. art. 20.04(Q) (Vernon Supp. 1978-79)); Comptroller's Administrative Decision No. 7253 (1978) (tangible personal property that was acquired tax-free by the taxpayer from out-of-state vendors, brought into Texas, and thereafter shipped outside of Texas as gifts to the taxpayer's customers was exempt from use tax pursuant to TEX. TAX.-GEN. ANN. art. 20.04(G)(3)(b) (Vernon 1969)); Comptroller's Administrative Decision No. 9526 (1978) (sterile, protective clothing furnished by an employer and used to prevent contamination of the product during various stages of manufacture and to protect employees from harmful effects is exempt from sales and use tax pursuant to TEX. TAX.-GEN. ANN. art. 20.04(E)(1)(b) (Vernon 1969) as tangible personal property necessary or essential to the manufacturing process).

118. Comptroller's Administrative Decision No. 8906 (1977) (insurance proceeds received as a result of the destruction of an aircraft are not subject to sales and use taxes since such payments represent indemnity for a loss and not receipts from the sale of tangible personal property); Comptroller's Administrative Decision No. 9427 (1978) (when property purchased in Texas under a direct payment permit certificate is only stored in Texas and then used solely outside the state, the direct payment permit holder is not liable for Texas use tax because storage incident to subsequent transportation out of state is excluded from taxation under TEX. TAX.-GEN. ANN. art. 20.01(O) (Vernon 1969)); Comptroller's Administrative Decision No. 9683 (1978) (when a customer places an order for tangible personal property and the seller must have the property shipped to it from the manufacturer, the transportation charges paid by the seller to the manufacturer for this shipment are properly includable in the seller's sales price because the charges are costs of transportation prior to sale, which are includable as "receipts" pursuant to TEX. TAX.-GEN. ANN. art. 20.01(D)(1)(c) (Vernon 1969)); Comptroller's Administrative Decision No. 9259 (1978) (the production of film or videotape for an advertising agency constitutes processing and is taxable as a sale of tangible personal property); Comptroller's Administrative Decision No. 8536 (1978) (when property purchased outside the state is shipped to the purchaser within Texas,

IV. INHERITANCE TAXES

The legislature amended article 14.02(1)¹¹⁹ to provide that the basic inheritance tax rate for taxable property passing to or for the use of a Class A beneficiary¹²⁰ shall be one percent of any value transferred not exceeding \$50,000. Previously, the one percent rate applied to the transfer of any value in excess of \$25,000 but not exceeding \$50,000.¹²¹ Sections (2) and (3) were added to article 14.02¹²² to provide that the amount of exemption for Class A transfers is \$200,000 for the period beginning September 1, 1978, through August 31, 1982; \$250,000 for the period beginning September 1, 1982, through August 31, 1985; and \$300,000 beginning on September 1, 1985.¹²³ When more than one Class A beneficiary receives property and the total amount of property passing to the Class A beneficiaries exceeds the amount of the exemption available under article 14.02(3), the amount of the exemption is to be divided among the beneficiaries in a manner proportional to the amount passing under article 14.02 to each beneficiary.¹²⁴ In no event shall a Class A beneficiary receive an exemption of less than \$25,000.¹²⁵ The legislature also added article 14.015(5),¹²⁶ which provides that military pay or other military allowances paid to the beneficiaries of a Texas resident who, while in active service of the armed forces of the United States, is killed in action in a combat zone or is legally declared dead after being classified as missing in action, is exempt from inheritance tax.

V. AD VALOREM TAXES

A significant development during the survey period was the attorney general's opinion that article 7150f¹²⁷ is unconstitutional.¹²⁸ The statute

use tax becomes due pursuant to TEX. TAX.-GEN. ANN. art. 20.031 (Vernon 1969) at the time of the first storage, use, or other consumption rather than at the time of invoicing by the vendor); Comptroller's Administrative Decision No. 9866 (1978) (labor charges for fabricating equipment are part of the sales price even though separately stated from the material charge); Comptroller's Administrative Decision No. 10041 (1978) (the comptroller is not required to file a lien against the seller of a business as a prerequisite to imposing the sales tax liability of the seller against the purchaser as a successor to the business pursuant to TEX. TAX.-GEN. ANN. art. 20.09(I) (Vernon 1969)); Comptroller's Administrative Decision No. 9126 (1978) (where property was sold to the taxpayer under a sales contract for \$1.00 and the taxpayer in turn cleared or forgave the transferor of a debt unrelated to the property sold, a taxable sale occurred for sales and use tax purposes with the sales price being \$1.00 plus the amount of the debt forgiven).

119. TEX. TAX.-GEN. ANN. art. 14.02(1) (Vernon Supp. 1978-79).

120. Class A beneficiaries include a husband or wife, any direct lineal descendant of a husband or wife, any direct lineal descendant or ascendant of the decedent, the legally adopted child or children, or any direct lineal descendant of the adopted child or children of the decedent, or the husband or a daughter or the wife of a son. *Id.*

121. The \$25,000 exemption is still available; it has merely been shifted to another subsection. See note 125 *infra* and accompanying text.

122. TEX. TAX.-GEN. ANN. art. 14.02(2)-(3) (Vernon Supp. 1978-79).

123. *Id.* art. 14.02(3).

124. *Id.* art. 14.02(2).

125. *Id.* art. 14.02(4).

126. *Id.* art. 14.015(5).

127. TEX. REV. CIV. STAT. ANN. art. 7150f (Vernon Supp. 1978-79).

128. TEX. ATT'Y GEN. OP. NO. H-1308 (1978).

prevents taxation of certain property under two fact situations. The first part of the statute pertains to property consigned from outside the state to a consignee in Texas to be forwarded to a point outside the state. If the property is entitled to be forwarded at through rates from the point of origin to the point of destination pursuant to Interstate Commerce Commission tariffs, rules and regulations, then the statute applies. The statute provides that if such property is not detained within Texas for more than ninety days, it is deemed to be property moving in interstate commerce and thus not subject to state taxation. The second part of the statute pertains to goods, wares, ores, and merchandise that originate outside of Texas and are detained in the state for not more than nine months for purposes of assembly, storage, manufacturing, processing, or fabricating. Such items are not subject to taxation because they are deemed to be located in Texas for only a temporary period and thus do not acquire taxable situs in the state.

The attorney general analyzed article 7150f in light of article VIII, section 1 of the Texas Constitution,¹²⁹ which, prior to its amendment in 1978, provided for the taxation of "[a]ll property in this state,"¹³⁰ and article VIII, section 2 of the Texas Constitution, which provides for specific exemptions from taxation and states that "all laws exempting property from taxation other than the property mentioned in this Section shall be null and void."¹³¹ Relying on prior cases that have interpreted these constitutional provisions,¹³² the attorney general reasoned that the constitutional framers intended that all property be subject to taxation unless specifically exempted by the Texas Constitution or by the legislature under constitutional authorization. The attorney general noted, however, that the state is prohibited by the commerce clause of the United States Constitution¹³³ from taxing any property in transit through the state.

With respect to the first segment of article 7150f, the attorney general reasoned that property described therein should in fact be exempt from state taxation only if the property is actually moving in interstate commerce and is thus immune from taxation pursuant to the United States Constitution. This determination, according to the attorney general, is a fact question to be determined on a case-by-case basis. While the attorney general recognized that some of the property described in the first part of article 7150f was unquestionably moving in interstate commerce, he argued against the presumption that all of the property described therein was

129. TEX. CONST. art. VIII, § 1.

130. The recently enacted amendment will not alter the attorney general's opinion because the section still provides that all real property and tangible personal property shall be taxed.

131. TEX. CONST. art. VIII, § 1.

132. *Leander Independent School Dist. v. Cedar Park Water Supply Corp.*, 479 S.W.2d 908 (Tex. 1972); *City of Wichita Falls v. Cooper*, 170 S.W.2d 777 (Tex. Civ. App.—Fort Worth 1943, writ ref'd).

133. U.S. CONST. art. I, § 8, cl. 3. TEX. CONST. art. I, § 1 provides that Texas is subject to the United States Constitution.

exempt from taxation pursuant to the United States Constitution. The attorney general concluded that to the extent the first part of article 7150f forbade taxation of property that Texas courts would hold had come to rest in the state, the provision would be held to be an unconstitutional attempt to exempt taxable property.

The attorney general's analysis of the second part of article 7150f framed the basic legal issue as involving constitutional limits on legislative authority to define taxable situs. Article VIII, section 11 of the Texas Constitution provides that all property shall be assessed for taxation in the county "where situated."¹³⁴ Relying on a prior Texas Supreme Court decision, which stated that the constitutional provision permits "reasonable legislative action" to fix tax situs,¹³⁵ the attorney general concluded that Texas courts would require the tax situs statutes to have a reasonable basis in fact and common law principles. Since article 7150f prohibits taxation of goods that are owned by Texas taxpayers, are physically present in the state for a sufficient time to acquire tax situs in common law, and are not exempt as being in interstate commerce, the attorney general further concluded that neither the facts nor common law principles supported the conclusion that taxable situs lay outside of Texas. The attorney general therefore opined that the Texas courts would find article 7150f invalid in that it goes beyond reasonable legislative action to define tax situs and instead uses tax situs as a vehicle for granting a property tax exemption.¹³⁶

During the survey period several developments concerning the assessment of agricultural lands for ad valorem tax purposes were significant. The Texas attorney general concluded that article VIII, section 1-d of the Texas Constitution,¹³⁷ which, in general, establishes a standard of assessment other than fair market value for land designated for agricultural use, probably does not apply to land owned by a Texas partnership.¹³⁸ Relying primarily on the decision in *Nacogdoches Independent School District v. McKinney*,¹³⁹ the attorney general reasoned that land owned by a partnership formed pursuant to the Texas Uniform Partnership Act¹⁴⁰ is to be treated for ad valorem tax purposes as property owned by a separate legal entity and not as property owned by the partners as individuals. Consequently, land owned by a partnership does not constitute "land owned by natural persons" as required by article VIII, section 1-d.

In another opinion relating to the agricultural assessment provisions of

134. TEX. CONST. art. VIII, § 11.

135. *Great S. Life Ins. Co. v. City of Austin*, 243 S.W. 778 (Tex. 1922).

136. The attorney general also relied on the decision of the Utah Supreme Court in *Foulger Equip. Co. v. State Tax Comm'n*, 16 Utah 2d 165, 397 P.2d 298 (1964), in which the court held that a similar statute violated a Utah constitutional provision requiring that all tangible personal property in the state, not exempt under the laws of the United States or the state constitution, be taxed in proportion to its value. The attorney general concluded that the Texas courts would hold that article 7150f violates the corresponding provisions of the Texas Constitution.

137. TEX. CONST. art. VIII, § 1-d.

138. TEX. ATT'Y GEN. OP. NO. H-1287 (1978).

139. 504 S.W.2d 832 (Tex.), *modified*, 513 S.W.2d 5 (Tex. 1974).

140. TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon 1970 & Supp. 1978-79).

the Texas Constitution, the attorney general concluded that a local tax assessor-collector could impose a requirement that applicants for the agricultural use designation furnish him with copies of relevant portions of their federal income tax returns.¹⁴¹ The attorney general noted, however, that a federal income tax return submitted to a tax assessor-collector by an applicant for the agricultural use designation is confidential and is thus exempted from disclosure under the Open Records Act.¹⁴²

In *Jay v. Devers*¹⁴³ the taxpayer filed suit against the tax assessor-collector to recover payment of 1974 ad valorem taxes paid under protest. The taxpayer contended that those taxes had been overpaid as a result of the tax assessor-collector's failure to assess her property pursuant to the agricultural use provisions of article VIII, section 1-d. The court denied recovery on two grounds. First, the court held that under Texas law there is no claim for recovery of taxes paid voluntarily, and a mere showing that ad valorem taxes were paid "under protest" will not mandate a finding of involuntary payment in support of the taxpayer's claim for recovery.¹⁴⁴ Second, the court held that the taxpayer's unsworn application to have the property assessed for agricultural use, which was filed on December 31, 1974, was not timely.

Failure to file a timely application for agricultural use treatment was also fatal to the taxpayer's case in *Moore v. White*.¹⁴⁵ In that case the taxpayer's application to have the property assessed for agricultural use for the year 1973 was filed on December 18, 1973. The court held that the taxpayer's application was not timely filed since the taxpayer waited until after the taxing authorities' plans of taxation were put into effect before filing the application for exemption.

The court in *Maxwell v. White*¹⁴⁶ also denied agricultural use treatment to a taxpayer. Upon denial of his application for agricultural use treatment, the taxpayer in *Maxwell* filed suit seeking to permanently enjoin the taxing authority from assessing his land on any basis other than an agricultural assessment. While the taxpayer's suit was pending on the court's docket without being actively prosecuted by the taxpayer, the taxing authority proceeded with the usual and customary activities of carrying its plan of taxation into effect. After the plan of taxation was put into effect, the taxpayer brought his suit to trial and obtained the requested injunctive relief from the trial court. Reversing the judgment of the trial court, the court of civil appeals held that when the taxpayer brought his suit to trial, his action for injunctive relief was moot since the taxing authority already had put its plan of taxation into effect. The court further held that since

141. TEX. ATT'Y GEN. OP. NO. H-1274 (1978).

142. TEX. REV. CIV. STAT. ANN. art. 6252—17a (Vernon Supp. 1978-79).

143. 563 S.W.2d 880 (Tex. Civ. App.—Eastland 1978, no writ).

144. The court cited *National Biscuit Co. v. State*, 134 Tex. 293, 135 S.W.2d 687 (1940); *Austin Nat'l Bank v. Sheppard*, 123 Tex. 272, 71 S.W.2d 242 (1934); and *Howell v. City of Dallas*, 549 S.W.2d 36 (Tex. Civ. App.—Waco 1977, writ ref'd n.r.e.).

145. 569 S.W.2d 533 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.).

146. 564 S.W.2d 396 (Tex. Civ. App.—Fort Worth 1978, no writ).

the taxpayer's gross income from commercial rentals on the property was five to six hundred percent greater than his gross income from his agricultural activities, as a matter of law he was disqualified from having his land assessed as agricultural use property.

The exemption from taxation of a rest home as a purely public charity pursuant to section 7 of article 7150¹⁴⁷ was upheld in *Needville Independent School District v. S.P.J.S.T. Rest Home*.¹⁴⁸ The school district attacked the rest home's right to the exemption on several grounds. First, the school district contended that the rest home failed to prove that it made no gain or profit from its operations. Relying on *City of McAllen v. Evangelical Lutheran Good Samaritan Society*,¹⁴⁹ the court held that the realization of a profit would not subject the organization to taxation if the profits were used to maintain or expand the organization's operations. In *Needville* the record established that all of the rest home's profits were used for capital improvements or mortgage payments. Second, the school district contended that the rest home failed to prove that it qualified as a purely public charity. To qualify for this status, a charitable organization must show that it assumes, to a material extent, costs that otherwise might become an obligation of the community or the state. The court held that the rest home met this condition for exempt status by accepting applicants without regard to their financial conditions. While payments were made by the State Welfare Department on behalf of some indigents, the rest home had a special charitable fund from which it subsidized the payments of those who could not afford to pay the complete costs.

The court in *Needville* distinguished the recently decided case of *Air Force Village Foundation, Inc. v. Northside Independent School District*.¹⁵⁰ In that case a tax exemption was denied an organization formed for the purpose of providing elderly persons with services and housing facilities specially designed for their needs. In upholding the jury findings that the Air Force Village Foundation was not a purely public charity, the court noted that while the charter of the organization mandated that at least one-third of the residents be persons that needed charity, the organization had been unable to attract persons in this category. Most of the residents of Air Force Village were high-ranking officers and their spouses or widows, and the percentage of residents actually receiving charity was extremely small when compared with the percentage of residents paying the full charges assessed by the organization. The court concluded that these facts could have led the jury to the reasonable conclusion that Air Force Village Foundation was an institution structured as a comfortable retirement home for retired officers and their spouses or widows and was not an institution structured in either form or operations to meet the special residential requirements of elderly persons suffering from distressed

147. TEX. REV. CIV. STAT. ANN. art. 7150, § 7 (Vernon Supp. 1978-79).

148. 566 S.W.2d 40 (Tex. Civ. App.—Beaumont 1978, no writ).

149. 530 S.W.2d 806 (Tex. 1975).

150. 561 S.W.2d 905 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.).

circumstances. The jury had grounds to believe that the institution, through its organization and actual operations, did not assume to a material extent any obligation or duty of the community or the state. Accordingly, the court of civil appeals held that the Air Force Village Foundation failed to establish that it was a purely public charity pursuant to section 7 of article 7150.

In *Satterlee v. Gulf Coast Waste Disposal Authority*¹⁵¹ the supreme court ruled that integrated regional waste facilities owned by the Gulf Coast Waste Disposal Authority were not exempt from ad valorem taxation. The disposal authority, a conservation and reclamation district formed pursuant to article XVI, section 59 of the Texas Constitution,¹⁵² claimed that the facilities and the land on which they were situated were exempt from ad valorem taxation pursuant to article VIII, section 2(a) of the Texas Constitution,¹⁵³ which authorizes the legislature to exempt public property used for public purposes, and section 4 of article 7150,¹⁵⁴ which exempts from taxation all property belonging exclusively to the state or any political subdivision thereof. The supreme court ruled that the facilities were not exempt from ad valorem taxation because the written instruments underlying the arrangement between the disposal authority and the participating industries, when viewed in their entirety, did not vest exclusive ownership of the property in the disposal authority as required for tax exemption. The court reasoned that the disposal authority's title to the facilities was encumbered by the underlying instruments for the use and benefit of various private industries and that the disposal authority held title only so long as the property was used as a facility for the treatment of industrial waste. The court therefore concluded that the disposal authority had substantially less than exclusive ownership of the property in question.

Relying on the supreme court's prior decision in *City of Beaumont v. Fertiitta*,¹⁵⁵ the disposal authority argued that even assuming that the underlying instruments gave the private industries an equitable interest in the facilities, this fact did not prevent the property from being exempt from taxation under section 4 of article 7150. Rejecting this argument, the court stated that in *Fertiitta* the legal title of the city of Beaumont was not encumbered as was that of the disposal authority under the facilities agreement, and no question was raised or decided in *Fertiitta* with respect to the exclusive ownership prerequisite to tax exemption. Since the court concluded that the disposal authority was not vested with the requisite exclusive ownership, it considered unnecessary a re-examination of the holding in *Fertiitta* that section 4 of article 7150 exempts municipal property from taxation regardless of the use to which it is put or the purposes for which it is held. In a concurring opinion Chief Justice Greenhill agreed with the court's judgment that the property in question was encumbered by the fa-

151. 22 Tex. Sup. Ct. J. 66 (Nov. 1, 1978).

152. TEX. CONST. art. XVI, § 59.

153. *Id.* art. VIII, § 2(a).

154. TEX. REV. CIV. STAT. ANN. art. 7150, § 4 (Vernon 1960).

155. 415 S.W.2d 902 (Tex. 1967).

cilities agreement for the use and benefit of the private industries, but was unable to reconcile the court's decision with the holding in *Fertiitta*. Noting that he had joined in the dissent in the *Fertiitta* case, Chief Justice Greenhill stated that *Fertiitta* was wrongly decided.

In its motion for rehearing the disposal authority argued that the property in question was exempt from taxation pursuant to article XI, section 9 of the Texas Constitution,¹⁵⁶ which exempts property of counties, cities and towns that is owned and held for only public purposes. Rejecting this contention, the court held that, for the reasons stated in its original opinion, the property did not satisfy the requirements of article XI, section 9 since the property was not held solely for public purposes and was not devoted exclusively to the use and benefit of the public.¹⁵⁷

In *Brunkon Toyota, Inc. v. City of Lubbock*¹⁵⁸ the court refused to invalidate a cycle reassessment program established by the city of Lubbock and the Lubbock Independent School District. Pursuant to this plan, the city was divided into five zones with the intent that one zone would be reappraised each year for tax purposes. The taxpayers contended that the cycle reassessment policy of the taxing authorities and their formula, method, and system of assessment adopted for the years 1975 and 1976 were invalid, arbitrary, and capricious. In rejecting the taxpayers' claims and upholding the cycle reassessment program, the court relied on an early holding of the United States Supreme Court that a taxpayer complaining of a reappraisal program must establish that the taxing authority intentionally violated the principle of uniformity.¹⁵⁹ The court also relied extensively on the holding of the Alabama Supreme Court in *Hamilton v. Adkins*,¹⁶⁰ in which a board of equalization had developed a four-year systematic plan of review and revision of assessments similar to the plan adopted by the city of Lubbock. The complainants in *Hamilton* alleged that the resulting inequality in their property valuations violated the Alabama Constitution's uniformity requirements, which were similar to those found in the Texas Constitution. In upholding the four-year revaluation plan, the Alabama Supreme Court held that there must be a systematic and intentional discrimination before the Alabama Constitution was violated. The court found no fraud or evil intent on the part of the board of equalization and pointed out that mere inequality in valuation did not contravene Alabama's constitutional provisions.

In upholding the city of Lubbock's cycle reassessment program, the Texas court relied on the strong presumption that a board of equalization acts in good faith in exercising its quasi-judicial function. The court fur-

156. TEX. CONST. art. XI, § 9.

157. 22 Tex. Sup. Ct. J. 176 (Dec. 29, 1978).

158. 558 S.W.2d 523 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.).

159. *Sunday Lake Iron Co. v. Township of Wakefield*, 247 U.S. 350 (1918).

160. 250 Ala. 557, 35 So. 2d 183 (1948). The court noted that cyclical revaluation programs also had been approved in *Skinner v. New Mexico State Tax Comm'n*, 66 N.M. 221, 345 P.2d 750 (1959), and *Carkonen v. Williams*, 76 Wash. 2d 617, 458 P.2d 280 (1969) (en banc).

ther held that a comparison of the assessed values of comparable property in other zones of the city with the assessed value applied to the taxpayers' properties failed to establish that the taxpayers had suffered substantial injury.

The constitutionality of two valuation statutes enacted by the legislature in 1977 was considered in an opinion of the Texas attorney general issued during the survey period.¹⁶¹ The first statute, article 7150/¹⁶² relates to the assessment of common areas in residential subdivisions or condominium complexes. Typically, such common areas are nominally owned by a non-profit corporation which assesses membership fees and maintains the facilities for the use and benefit of the residents of the subdivision or condominium complex. Article 7150/ requires that all property held by such nonprofit corporations be assessed for tax purposes on the basis of a nominal value. The statute is based upon the recognition that the valuation of the common areas is actually reflected in the enhanced valuation of the property owned by the individual members and the assessment of such nominally owned property on the basis of its fair market value would result in double taxation. The attorney general concluded that article 7150/ violates article VIII, section 1 of the Texas Constitution¹⁶³ because it applies a standard other than market value. The attorney general recognized, however, that the property nominally owned by such nonprofit corporations is in effect burdened with an easement in favor of the corporation's members, and that such easement will diminish the value of the servient estate and increase the value of the dominant estate. While the attorney general noted that a tax assessment must recognize the decreased value of the servient estate, he concluded that it was improper for the legislature to mandate that in all instances the value of the servient estate was nominal.

The second statute considered in the opinion, article 7150n,¹⁶⁴ prescribes a procedure whereby the owner of fee simple title to a five-or-more-acre tract of real estate may limit the use of the land to recreational, park, or open space use for a term of ten or more years by filing an appropriate restriction instrument with the county clerk. Such restriction instrument can be enforced in the same manner as deed restrictions by the county attorney or by any person owning or having any interest in the restricted property. The statute provides that when assessing such restricted property, the tax assessor shall consider no factors other than those relative to the value of the land as restricted. In concluding that article 7150n was valid, the attorney general reasoned that the statute adopted the constitutional standard of market value and recognized that market value must be ascertained in light of the relevant deed restrictions or restriction instruments.

161. TEX. ATT'Y GEN. OP. NO. H-1220 (1978).

162. TEX. REV. CIV. STAT. ANN. art. 7150/ (Vernon Supp. 1978-79).

163. TEX. CONST. art. VIII, § 1.

164. TEX. REV. CIV. STAT. ANN. art. 7150n (Vernon Supp. 1978-79).

In *El Campo Independent School District v. Kimmey*¹⁶⁵ the supreme court held that article 7297,¹⁶⁶ which provides that the state and county are exempt from liability for any costs growing out of a collection suit, is available to school districts by virtue of article 7343,¹⁶⁷ which provides that all laws enacted for the purposes of collecting delinquent state and county taxes are also available to cities, towns, and independent school districts. Thus, the court ruled that costs could not be assessed against either the school district that filed the delinquent tax suit or against the state, county, or city that intervened in the school district's suit. Other decisions and attorney general opinions that were issued during the survey period and relate to ad valorem taxes are set forth in the notes.¹⁶⁸

A significant development during the survey period was the enactment and approval by the electorate of amendments to article VIII of the Texas Constitution. Article VIII, section 1 was amended to repeal the poll tax, to

165. 571 S.W.2d 865 (Tex. 1978).

166. TEX. REV. CIV. STAT. ANN. art. 7297 (Vernon 1960).

167. *Id.* art. 7343.

168. *Gray-Taylor, Inc. v. Harris County*, 569 F.2d 893 (5th Cir.), *cert. denied*, 99 S. Ct. 351, 58 L. Ed. 2d 344 (1978) (the federal district court properly dismissed a class action suit brought by taxpayers seeking to enjoin the county's implementation of its tax system when there was pending in state court a suit by a different plaintiff against the same defendants seeking the same class action injunctive relief); *Lifetime Communities, Inc. v. Carrollton-Farmers Branch Independent School Dist.*, 568 S.W.2d 667 (Tex. Civ. App.—Eastland 1978, no writ) (award of attorneys' fees to a school district in the amount of 10% of the delinquent taxes, penalties and interests awarded to the school district was proper); *Watkins v. New Diana Independent School Dist.*, 568 S.W.2d 456 (Tex. Civ. App.—Texarkana 1978, no writ) (taxpayers' suit to enjoin approval of tax roll and collection of tax on grounds that tax roll was prepared under and based on a fundamentally erroneous and arbitrary plan of valuation was not subject to involuntary dismissal; if taxpayers had not stated a cause of action, they should have been afforded an opportunity to amend their pleadings); *Campbell v. County of Bexar*, 567 S.W.2d 852 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.) (when a taxpayer attacks the assessment of taxes against him on the ground that the plan or system used by the taxing authority was arbitrary or illegal, the taxpayer must sustain the burden of proving not only that the plan was arbitrary and illegal, but also that the use of the plan operated to his substantial injury); *Del Valle Independent School Dist. Bd. of Equalization v. Hackett*, 563 S.W.2d 338 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.) (taxpayers established that school district utilized fundamentally wrong and erroneous scheme of taxation in that tax assessor utilized unequal valuations of comparable properties in different sections of the district); *Keystone Operating Co. v. Runge Independent School Dist.*, 558 S.W.2d 82 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (in delinquent tax suit taxpayer has burden of showing gross discrimination against him by virtue of comparison of assessments against his property with assessments against other like property; otherwise taxpayer can defeat recovery of taxes only to the extent they were excessive, and taxpayer must assume burden of proving excessiveness and must show the extent to which the plan of taxation worked to his substantial injury); TEX. ATT'Y GEN. OP. NO. H-1187 (1978) (Houston Independent School District resolution granting an additional \$10,000 homestead tax exemption to citizens 65 years of age or older whose annual income is below a particular amount violates TEX. CONST. art. VIII, § 1-b, which empowers political subdivisions to grant a homestead tax exemption based solely on the taxpayer's age and residence on the homestead property); TEX. ATT'Y GEN. OP. NO. H-1108 (1977) (properties purportedly leased by cities to private manufacturers were not exempt from taxation because the cities never legally acquired an ownership interest in such properties; although property that the tax assessor-collector lists on the tax rolls as non-exempt cannot be reclassified as property exempt from taxation by the county commissioners court sitting as a board of equalization, assessments made by a tax assessor-collector on such properties later can be reviewed by the commissioners court, sitting as the court, which may order the assessments reassessed).

provide that all real and tangible personal property be taxed according to its value, and to authorize the legislature to provide for taxation of intangible personal property.¹⁶⁹ Prior to its amendment, section 1 required that all property, including intangible personal property, be taxed according to its value. The amendments to article VIII, section 1 also provide that the legislature shall exempt household goods and personal effects not held or used for the production of income. Prior to the amendment, \$250 worth of household and kitchen furniture was exempt from tax. The amendments also authorized the legislature to exempt from taxation all or part of the personal property homestead of a family or single adult. The term "personal property homestead" is defined to mean personal property exempt by law from forced sale for debt.

The amendments added article VIII, section 1-d-1,¹⁷⁰ which requires the legislature to provide by general law for taxation of open space land devoted to farm or ranch purposes on the basis of its productive capacity. The legislature also was given authority to provide by general law for taxation of open space land devoted to timber production on the basis of its productive capacity. In addition, the legislature was empowered to provide eligibility limitations and to impose sanctions in furtherance of the taxation policy of this provision. If a property owner qualifies his land for designation as agricultural use property, pursuant to article VIII, section 1-d,¹⁷¹ the land is subject to the provisions of section 1-d for the year in which the designation is effective and is not subject to any laws enacted under section 1-d-1 during that year.

The basis of the residential homestead exemption for the elderly was changed through amendments to article VIII, section 1-b.¹⁷² The amendments to section 1-b(b) change the basis of the residence homestead exemption for the elderly that can be enacted by political subdivisions from assessed value to market value of the residence homestead. The \$3,000 homestead exemption has been extended to persons who are determined to be under a disability for purposes of payment of disability insurance benefits under Federal Old-Age, Survivors, and Disability Insurance or its successor. An eligible disabled person who is also sixty-five years or older may not receive both exemptions from the same political subdivision in the same year, but may choose either exemption if the subdivision has adopted both.

The amendments also added article VIII, section 1-b(c),¹⁷³ which exempts \$5,000 of the market value of a residence homestead of a married or unmarried adult from property taxation for general elementary and secondary public school purposes. In addition to this exemption, the legislature has been authorized to exempt an additional \$10,000 of a residence homestead of a disabled person and of a person sixty-five years of age or older.

169. TEX. CONST. art. VIII, § 1.

170. *Id.* § 1-d-1.

171. *Id.* § 1-d.

172. *Id.* § 1-b(b).

173. *Id.* § 1-b(c).

The additional exemption may be based on economic need. An eligible disabled person who is sixty-five years or older may not receive both exemptions from a school district, but may choose either. If an ad valorem tax previously has been pledged for the payment of school district debt and cessation of the levy would impair the obligation of the contract by which the debt was created, the taxing officers of a school district may continue to levy and collect the tax against the value of homesteads exempted under article VIII, section 1-b(c) until the debt is discharged. If a person receives the additional homestead exemption based on age, property taxes cannot be increased on such person's residence homestead unless the value of the homestead is increased by improvements other than those made to comply with governmental requirements.¹⁷⁴ The legislature is required to provide formulas to protect school districts against all or part of the revenue loss incurred by the implementation of article VIII, sections 1-b(c), 1-b(d) and 1-d-1.¹⁷⁵

Article VIII, section 21¹⁷⁶ was added to provide that the total amount of property taxes imposed by a political subdivision in any year may not exceed the total amount of property taxes imposed by that subdivision in the preceding year, unless the governing body of the subdivision gives notice of its intent to consider an increase in taxes and holds a public hearing on the proposed increase before acting. In calculating the total amount of taxes imposed in the current year, the taxes on property in territory added to the political subdivision since the preceding year and on new improvements that were not taxable in the preceding year are excluded. In calculating the total amount of taxes imposed in the preceding year, the taxes imposed on real property that is not taxable by the subdivision in the current year are excluded. The legislature is required to provide by general law that a property owner be given notice of a revaluation and of the amount of taxes that will result from the reappraised value if neither the tax rate nor the assessment ratio in effect during the preceding year is reduced.

Article VIII, section 22¹⁷⁷ was added to provide that in no biennium shall the rate of growth of appropriations from state tax revenues not dedicated to specified purposes by the constitution exceed the estimated rate of growth of the state's economy. The legislature may provide for appropriations in excess of this amount if it adopts a resolution approved by a record vote of the majority of the membership of each house that an emergency exists and such emergency is identified. In no case, however, can appropriations exceed revenues.

Statewide appraisal of real property for ad valorem tax purposes is prohibited by article VIII, section 23.¹⁷⁸ Nevertheless, formula distribution of tax revenues to political subdivisions of the state is not precluded by this

174. *Id.* § 1-b(d).

175. *Id.* § 1-b(c).

176. *Id.* § 21.

177. *Id.* § 22.

178. *Id.* § 23.

amendment. Section 23 also provides that administrative and judicial enforcement of uniform standards and procedures for appraisal of property for ad valorem tax purposes shall originate in the county in which the taxes are imposed, except that the legislature may provide by general law for political subdivisions with boundaries extending outside the county.

Legislation was enacted to restrict increases in property taxes by local taxing units.¹⁷⁹ The statute provides that a taxing unit may not impose property taxes in any year until its governing body has adopted a tax rate for that year. The taxing unit's governing body may not adopt a tax rate that exceeds the rate calculated and announced for the preceding tax year by more than three percent until it has given public notice of its intention to adopt a higher rate and has held a public hearing on the proposed increase.¹⁸⁰ A specific method is provided for computation of the effective tax rate,¹⁸¹ and procedures are set forth for providing notice of the tax increase, for holding a public hearing, and for holding a meeting for voting on the proposed increase.¹⁸² The statute also requires the tax assessor-collector to mail a written notice to each property owner whose property value has been increased by more than \$100 above its value in the preceding year.¹⁸³

VI. MISCELLANEOUS STATE TAX MATTERS

During the survey period the United States Supreme Court handed down several significant decisions in the state tax area. In *Department of Revenue v. Association of Washington Stevedoring Cos.*¹⁸⁴ the Court held that the State of Washington could apply its business and occupation tax to stevedoring without violating the Constitution. The taxpayers challenged the validity of the tax on the grounds that it violated both the commerce clause¹⁸⁵ and the import-export clause¹⁸⁶ of the United States Constitution. Relying on *Complete Auto Transit, Inc. v. Brady*,¹⁸⁷ the Court held that to be consistent with the commerce clause a tax must meet the following four requirements: it must be applied to an activity that has a substantial nexus with the state, it must be fairly apportioned, it cannot discriminate against interstate commerce, and it must be fairly related to the services provided by the state. The Court concluded that the Washington tax satisfied these standards in that the stevedoring operations were conducted entirely within the state, the tax was levied solely on the value of the loading and unloading that occurred in Washington, the tax rate did not discriminate against interstate commerce, and there was nothing in the

179. 1978 Tex. Sess. Law. Serv., 2d Called Sess., ch. 8, §§ 1-8, at 18 (Vernon).

180. *Id.* § 2, at 19.

181. *Id.* § 1, at 18.

182. *Id.* §§ 3-4, at 18-19.

183. *Id.* § 5, at 20.

184. 435 U.S. 734 (1978).

185. U.S. CONST. art. I, § 8, cl. 3.

186. *Id.* § 10, cl. 2.

187. 430 U.S. 274 (1977).

record to suggest that the tax was not fairly related to the services and protection provided by the state.

In considering whether the Washington tax violated the import-export clause, the Court applied the tests developed in *Michelin Tire Corp. v. Wages*.¹⁸⁸ Prior to *Michelin*, state taxes on imported goods that were still in the "original package" and on exported goods that had entered the "export stream" were banned by the import-export clause. In *Michelin* the Court replaced these tests with an analysis that examined whether the tax offended any of the three policy considerations that led to the inclusion of the import-export clause: (1) did the tax usurp the federal government's authority to regulate foreign commerce and policy uniformly; (2) did the tax deprive the federal government of import revenues by diverting them to the state or by significantly raising the cost of imported goods and thereby lowering consumer demand; and (3) did the tax cause friction and disharmony among the states by enabling favorably situated coastal states to exact a tax on goods destined for inland states.

Applying this analysis, the Court determined that the application of the Washington business and occupation tax to stevedoring did not threaten the policies underlying the import-export clause. First, the tax did not restrain the ability of the federal government to conduct foreign policy, and as a general business tax that applied to virtually all businesses in the state, the tax did not create any special protective tariff. Second, the effect of the Washington tax on federal import revenues was determined to be identical to the effect in *Michelin*. The tax merely compensated the state for services and protection, such as police and fire, extended by Washington to the stevedoring business. The Court stated that any indirect effect on the demand for imported goods caused by the tax on the value of loading and unloading them from their ship was even less substantial than the effect of a direct ad valorem property tax on the imported goods themselves. Third, the Court held that since the prevention of interstate friction did not differ significantly from the primary purpose of the commerce clause, a tax meeting the four commerce clause conditions set forth in *Complete Auto Transit* necessarily satisfied the third test set forth in *Michelin*.

Several possible bases for distinguishing the *Michelin* decision were rejected by the Court. The Court noted that the activity taxed by the State of Washington occurred while imports and exports were in transit, while in *Michelin* the goods that were taxed already had reached their destination. Nevertheless, the Court held that since the Washington tax fell upon a service as opposed to the goods themselves, the *Michelin* policy analysis should not be discarded merely because the goods were in transit. Further, although the state tax in question in *Michelin* touched only imports, the Court held that the *Michelin* analysis would apply to taxation involving exports as well.

The taxpayers made two additional arguments, both of which were rejected by the Court. First, the taxpayers argued that the import-export

188. 423 U.S. 276 (1976).

clause effected an absolute prohibition on all taxation of imports and exports. Rejecting this contention, the Court held that the import-export clause prohibited only "imposts or duties" and did not necessarily encompass all taxes. Second, the taxpayers argued that the Washington tax imposed a transit fee upon inland consumers which violated the import-export clause. Rejecting this argument, the Court held that, as is the case in commerce clause jurisprudence, interstate friction will not chafe when commerce pays for the state services it enjoys. The Court concluded that fair taxation could be assured by the prohibition of discrimination and by the requirements of apportionment, nexus, and reasonable relationship between tax and benefits. The Court reasoned that a requirement that coastal states subsidize the commerce of inland consumers could well exacerbate, rather than diminish, friction among the states.

The validity of the Multistate Tax Compact, of which Texas is a member,¹⁸⁹ was sustained in *United States Steel Corp. v. Multistate Tax Commission*.¹⁹⁰ The Multistate Tax Compact was entered into by a number of states for the stated purposes of (1) facilitating proper determinations of state and local tax liabilities of multistate taxpayers; (2) promoting uniformity and compatibility in state tax systems; (3) facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) avoiding duplicative taxation. To these ends the compact created the Multistate Tax Commission, which is composed of the tax administrators from all the member states. The commission is authorized to study state and local tax systems, to develop and recommend proposals to increase uniformity in state and local tax laws, and to compile and publish information that may assist member states in implementing the compact and multistate taxpayers in complying with the tax laws.

The commission is authorized to adopt uniform administrative regulations that are advisory only, and each member state has the power to reject, disregard, amend, or modify any rules or regulations promulgated by the commission. Such rules and regulations have no force in any member state until adopted by the state in accordance with its own law. Any member state, or a political subdivision thereof, is authorized to request that the commission perform an audit on its behalf, and the commission, as the state's auditing agent, may seek compulsory process in aid of its auditing power in the courts of any state specifically permitting such procedure. Individual member states retain complete control over all legislation and administrative action affecting the rate of tax, the composition of the tax base, and the means and methods of determining tax liability and of collecting any taxes determined to be due. Each member state is free to withdraw from the compact at any time.

United States Steel challenged the constitutionality of the compact on the grounds that (1) it was invalid under the compact clause of the Consti-

189. TEX. REV. CIV. STAT. ANN. art. 7359a (Vernon Supp. 1978-79).

190. 434 U.S. 452 (1978).

tution,¹⁹¹ which prohibits any state from entering into any agreement or compact with another state without the consent of Congress; (2) it unreasonably burdened interstate commerce; and (3) it violated the rights of multistate taxpayers under the fourteenth amendment.¹⁹² The Court held that the Multistate Tax Compact was valid under the compact clause even though it had never received congressional approval. The Court relied on the interpretation of the compact clause set forth in *Virginia v. Tennessee*¹⁹³ to the effect that the consent of Congress is necessary only for those agreements between states which may tend to increase and build up the political influence of a contracting state so as to encroach upon or impair the supremacy of the federal government or interfere with the federal government's rightful management of particular subjects placed under its control. The Court concluded that the Multistate Tax Compact does not enhance state power at the expense of federal supremacy because the compact does not purport to authorize the member states to exercise any power they could not exercise in its absence. Further, there was no delegation of sovereign power to the Multistate Tax Commission; each state retained complete freedom to adopt or reject the rules and regulations of the commission and was free to withdraw at any time.

The Court also rejected contentions that certain practices of the commission, including its use in audits of "unitary business" and "combination of income" methods for determining a corporate taxpayer's income, encroached upon federal supremacy with respect to interstate commerce. The Court reasoned that whether or not these risks were real, they could not be attributed to the existence of the commission because the regulations and practices proposed by the commission were merely advisory until made law by each member state, and any state could choose to adopt such practices even if the compact did not exist. Thus, any possible interference with interstate commerce was not due to the compact.

Similarly, the Court concluded that the commission's enforcement powers did not encroach upon federal supremacy. The Court reasoned that such enforcement powers amounted to nothing more than reciprocal legislation for providing mutual assistance to the auditors of the member states and did not enhance state power to the detriment of federal supremacy.

In addition, the Court rejected arguments that the compact encroached upon the federal government's powers with respect to foreign relations. It was contended that the commission had conducted multinational audits in which it had applied the unitary business method to foreign corporate taxpayers, a procedure that would be in conflict with tax conventions between the United States government and various foreign governments. In rejecting this argument, the Court reasoned that in performing its audits the commission adopted the particular methods specified by the states requesting the audits. Thus, the existence of the compact had no bearing on an

191. U.S. CONST. art. I, § 10, cl. 3.

192. *Id.* amend. XIV.

193. 148 U.S. 503 (1893).

individual state's ability to utilize the unitary business method in determining the income of a multinational taxpayer. Challenges to the compact under the commerce clause and the fourteenth amendment on the grounds that the commission induced states to issue burdensome requests for the production of documents and to violate their own laws by issuing arbitrary assessments were summarily rejected. The Court held that these allegations did not establish a violation of either the commerce clause or the fourteenth amendment. Further, the Court noted that only the individual states, and not the commission, had the power to issue assessments, and state remedies were available for violations of state law.

In *Moorman Manufacturing Co. v. Bair*¹⁹⁴ the Court upheld the validity of Iowa's single-factor sales formula for apportioning the income of interstate businesses for state income tax purposes. Under the Iowa income tax statute, if a corporation's business was not conducted entirely within Iowa, a tax was imposed only on the portion of its income "reasonably attributable to its business within the state." The statute set forth two steps to compute the share of the corporation's income "reasonably attributable" to Iowa. First, certain income, "the geographical source of which is easily identifiable," is attributed entirely to the state within which it is earned. Second, if the remaining income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state is the proportion which the gross sales made within the state bear to the total gross sales. If the taxpayer believes that application of this single-factor formula subjects it to taxation on a greater portion of its net income than is "reasonably attributable" to business within Iowa, it may file a statement of objection and submit an alternative method of apportionment.

The taxpayer, an Illinois corporation selling animal feed manufactured in Illinois to Iowa customers through Iowa salesmen and warehouses, brought an action alleging that the Iowa single-factor formula violated the commerce clause¹⁹⁵ and the due process clauses of the fifth¹⁹⁶ and fourteenth¹⁹⁷ amendments. The Court rejected the taxpayer's arguments and sustained the validity of the statutes.

The taxpayer based its due process clause claim on the premise that any state taxing formula that reaches income not in fact earned within the taxing state violates due process. The taxpayer claimed that Iowa's apportionment formula resulted in the taxation of income generated outside of Iowa by the taxpayer's Illinois manufacturing operations. The Court rejected this argument on the ground that the record did not contain any accounting analysis showing what portion of the corporation's net income was attributable to its Illinois operations; the taxpayer had not attempted to apportion its profits among its sales activities, manufacturing opera-

194. 437 U.S. 267 (1978).

195. U.S. CONST. art. I, § 8, cl. 3.

196. *Id.* amend. V.

197. *Id.* amend. XIV.

tions, and other phases of its business. Further, even if the record contained such proof, the Court held that the due process clause does not prohibit state taxing formulas that may result in taxation of some income that did not have its source in the taxing state. In this connection the Court reasoned that the due process clause places two restrictions on a state's power to tax income generated by the activities of interstate business. First, no tax may be imposed unless there is some minimal connection between those activities and the taxing state. Second, the income attributed to the state for tax purposes must be rationally related to "values connected with the taxing state." The Court held that the first requirement plainly was satisfied and that the statute could be held invalid under the second requirement only if the taxpayer produced clear and cogent evidence that the income attributed to Iowa was in fact out of all appropriate proportion to the business transacted in Iowa or led to a grossly distorted result. Since the taxpayer failed to show that the single-factor formula produced an arbitrary result, the taxpayer's due process claim was rejected.

The taxpayer's commerce clause claim was based on the contention that both Illinois and Iowa taxed part of the income derived from the taxpayer's Iowa sales and that this duplicative taxation was caused by Iowa's single-factor apportionment formula. The Court dismissed the taxpayer's duplicative taxation argument as speculative, again emphasizing that the taxpayer failed to present accounting evidence as to the portions of its net income derived from each state. Further, the Court reasoned that even assuming some overlap existed, the Iowa single-factor apportionment formula was not necessarily at fault because the duplication would be the result of the use of different taxing formulas by the various states in which the taxpayer conducted business.

In addition, the Court held that the commerce clause does not prohibit all overlapping taxation of interstate businesses. In this connection, the Court reasoned that if the commerce clause were read to mandate a prohibition against any overlapping taxation of interstate businesses, such a holding would require the enactment of national uniform rules for the apportionment of interstate corporations' net incomes. The Court stated that the power to enact such uniform rules was granted to the Congress and not to the judiciary.